Business Loans: What Every Entrepreneur Needs to Know

By Rieva Lesonsky

As your business grows, you may need more capital than you can get from your operational cash flow. If you are not funding your growth with equity, small business loans are another option to consider. What do small business owners need to know about getting a business loan? I talked to Max Ordonez, a business advisor with the Los Angeles Regional Small Business Development Center (LA SBDC), and an advisor for the *Goldman Sachs 10,000 Small Businesses* program, both at Long Beach City College, to find out.

The Goldman Sachs *10,000 Small Businesses* program gives growth-oriented entrepreneurs the tools they need to create jobs and economic opportunity. (Read more about how the Goldman Sachs *10,000 Small Businesses* program works.) Ordonez works with business owners who are ready to take their companies to the next level—and who often need financing to get there. "Typically, they've identified a growth opportunity, such as adding a new product or service or entering a new market," he explains.

The most important factor banks consider when reviewing a loan application is your cash flow, says Ordonez. Banks look at 3 years of business tax returns and 3 years of personal tax returns to determine a business owner's net global cash flow.

"Global cash flow includes both cash flow generated by the business and personal cash flow needs," says Ordonez. "If your business makes $100K a year but your personal lifestyle requires spending $90K a year, your net global cash flow is not $100K, it's $10K."

If this figure is insufficient to repay the expected amount of the loan, banks will not lend to you, says Ordonez. Failing to understand the concept of global cash flow—or to understand their business's financials in general—are frequent mistakes he sees among business owners seeking financing. (Learn more about understanding your financial statements.)

Not knowing how much money you need is another common mistake, Ordonez says. “You have to be able to tell banker exactly how much money you need and how the funds will be used,” he explains. If you’re planning to buy equipment, for instance, don’t guesstimate—get price quotes from vendors. “Asking for ‘As much as I can get’ is not what bankers want to hear,” he says. “You need to do the homework and prepare a cash flow forecast.” Being able to explain your strategy for growing revenues is also important.

Many small business owners struggle to get loans because they don’t talk to the right people at the bank. “The first bank they go to is where they already have a banking relationship, which is a logical place to start,” Ordonez says. “[But] usually the person they talk to that handles their personal accounts is not the right person to talk to. You need to develop a relationship with the commercial lending person—the person who does business loans—and understand what their requirements are.”

Banks are most likely to lend businesses money for the purchase of tangible assets, such as equipment, machinery or vehicles, Ordonez says. “They want collateral—anything they can attach a lien to,” he explains. For business owners seeking tangible assets, that’s good news, as it means more lenders in the space and more competitive pricing for the business.

For service businesses, however, it’s not so easy. Intangible assets like customer lists and goodwill aren’t enough to collateralize a loan. The good news: traditional bank loans are not your only option, although they’re the first one most small business owners think of. Nontraditional lenders, SBA Express loans, or small loans from sources such as nonprofit CDFIs (community development financial institutions) can be a better fit for many entrepreneurs. There are also a number of other options depending on your type of business. For example, financing based on receivables may make sense for some businesses.

No matter what type of business you own or what kind of loan you’re seeking, Ordonez offers this advice: “Talk to someone who has been successful getting financing, maybe in the area you’re looking for, or seek a resource, like the SBDC’s Capital Access Team, experts who can walk you through the forest, help you understand the terms, and help you put a good loan package together to be more bankable.”

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