

Introduction to Small Business Loans

Everything you need to know when applying for a small business loan.

Getting your first small business loan is a major milestone. But so is going through the application process! From making the decision to seek financing to putting together a small business loan application, you're learning and growing as a small business owner. Applying for small business loans can also be daunting. It takes wisdom and foresight. If you prepare mentally and practically before applying, the process can be nearly painless. We'll show you what you need to know so you can get the best small business loan offer with the least stress.

Before You Apply

Before you submerge yourself in the small business loan application process, make sure you understand your options. Are you sure you need financing? If so, is a [term loan](#) the best option for your industry and stage of growth? Small business financing is available in many forms, from business credit cards and small business loans, to invoice financing or factoring, to angel investment. Understand the pros and cons of each so you know what to expect and where to find the most appropriate financing for you.

Once you're ready to dive into the world of small business loans, you'll need to get a firm grasp of two essentials: your credit and your use case. With that knowledge, you're ready to prepare a successful application for a small business loan.

Analyze Your Credit

When it comes to small business loans, credit is king. It makes sense. Would you lend a friend \$100 if their track record showed that they'd probably never pay you back? What about a total stranger? In the same way, lenders of small business loans need to know how much they can trust you with their money. Your credit score is basically numerical shorthand for your financial reputation.

Your [personal credit score](#) and [business credit score](#) strongly affect whether a lender will offer you a small business loan. They also affect how favorable the terms of the loan will be. It's not the whole picture, of course, which is why at Bond Street we look at more than just credit score. Personal and business credit scores are two of the three pillars of our own analysis of small business loan applications. So let's take a look at how to understand and

improve these important digits.

Your Business Credit Score

Small business owners are notorious for mixing their personal and business finances, especially at the start of a new venture. The problem with overlapping accounts is that they can cause huge headaches when it's time to file taxes or apply for a small business loan. Establishing business accounts early also gives you the chance to build a credit history. It also prevents personal issues from affecting your [business credit score](#) and vice versa. Separate business and personal accounts as soon as possible to protect yourself and avoid confusion.

As you do business, you are building a business credit report. How does a credit report translate into a score? There are technically different companies that calculate slightly different scores. The [Dun & Bradstreet](#) PAYDEX score takes nothing but your payment history into account. [Experian](#) and [Equifax](#) also consider legal filings, public records, and collection agency data. All three scoring systems come up with three digits, but each employs a different scale. To [maintain a healthy business credit score](#) in any system, paying your bills on time is key.

Your Personal Credit Score

Even after you've established separate financial accounts for your business, your [personal credit score](#) still matters to lenders of small business loans. Imagine hiring a professional driving instructor only to discover he's accumulated a dozen moving violations in his off time. In the same way, your personal creditworthiness matters in business relationships.

What determines your personal credit score? As with a business credit score, the most important factor is your history of payments. The more often you pay your bills on time, the better your score is. This is true of both your [FICO score](#) and the newer [VantageScore](#), which both range from 300-850.

But paying on time doesn't guarantee a great score and great terms for your small business loan. Other factors include total debt owed, types of credit you've had, the length of your credit history, how much available credit you've used (i.e. utilization rate), and how often you've applied for credit in the past.

Common mistakes that lead to lower business and personal credit scores include:

- **Having a high outstanding balance.** Even if you've never missed a payment, you will be penalized for carrying a lot of debt. Making minimum payments is great; paying enough to keep your balance low is better.
- **Not understanding utilization.** Credit utilization measures the amount of your revolving credit limits currently in use. The VantageScore will penalize you more than the FICO score for having a high utilization rate. Calculate your utilization percentage by dividing your balance by the credit limit and multiplying by 100. Try to keep your utilization under 10%.

Remember, your personal credit score matters to lenders. Whether you want to apply for a small business loan or a mortgage, apply best practices to your personal accounts.

How to Improve Your Credit Score Before Applying for a Loan

The first step to raising your personal and business credit score is accessing the information credit bureaus use to calculate them. Accessing your credit report is free and easy thanks to the Fair Credit Reporting Act. For business credit reports, visit [Nav](#) (formerly Creditera) or [CreditSignal](#)'s website. There are even more options for personal credit reports, including [freecreditreport.com](#), [Credit Karma](#), and [AnnualCreditReport.com](#).

Simply accessing your credit report is a huge step to preparing for a small business loan. While [raising your credit score](#) is generally an exercise in patient persistence, your credit report gives you the information you need to make some quick fixes.

- **Check for errors in the report.** It's not uncommon for businesses to find out that certain trades that could boost your score haven't been reported or to see accounts that aren't yours in your report. For both personal and business reports, look for mistakes made by your bank and negative activity you've already addressed. If you catch an error, report it. Keep in mind that errors or late payments will remain on your credit report won't disappear until after they've been successfully disputed.
- **Look for any past-due debts.** You'll see them all on the report, along with how much you owe and to whom. Get in touch with your creditors and pay your debt down quickly. You can even ask for a goodwill adjustment, in which a lender erases a late payment from the report. And don't forget to pay down your credit card debt as much as possible!
- **Pay off any tax liens.** If you have a federal or state tax lien, reach out to the relevant government entities and get started on a payment plan. Better yet, pay off the whole thing at once.

Clearing up errors and late payments will boost your score in the short-term, but the only way to close in on a perfect score is applying good habits long-term. Some are common knowledge, while others may surprise you. These practices will help you get good rates on any debt, from car loans to small business loans.

- **Keep your balance down.** Try always to use less than 30% of the total credit available to you. (Some experts say that than 10% is ideal.) This shows that you're able to pay your debts, but that you don't need to rely on debt financing for all your needs.
- **Keep your utilization rate low.** Don't close an account just because you've finished paying it off. This lowers the total amount of credit you have available, which could negatively affect your score.
- **Diversify your credit mix, if you can afford to.** Buying something on installment (like a home or car) or opening a credit account (other than a credit card) generally improves your score, assuming you can pay it. At the same time, opening several accounts at once can hurt your score, making you seem desperate for funds.
- **Hire a credit monitoring service.** Credit bureaus and other companies offer monitoring services starting at \$20 per month. If you want to stay on top of your credit report or check the credit of companies you want to do business with, this can be a great investment.

Know Your Use Case When Applying for a Loan

Credit scores are simple: higher is always better. When it comes to small business loans, however, more is not always better. Many have staggered under the weight of small business loans they can't repay. As a small business owner, you need to figure out exactly how much money you need as well as how much you can afford. Working with an accountant before applying for a small business loan can help you get accurate estimates of both amounts.

Make Your Request Specific

Making your request as specific as possible helps you even more than it helps lenders assess your small business loan application. Know exactly what you're asking for and why.

An excellent way to show you understand your business is to build out a [budget](#) for the funds you'd get from a small business loan. Estimate what you want to use them for and how much that will cost. If you need to buy an expensive piece of equipment, cite the market price of that piece and any associated costs. Project how much revenue owning that

machine will bring into your business. These numbers don't need to be precise; just use whatever information you have to back up your request for a small business loan.

It's easy to justify needing money, but when you know your needs inside out, you're more likely to receive a small business loan offer for that amount.

Study Your Financial Statements

Like credit scores, [financial statements](#) say a lot about your business at a glance. Take a look at your financials from the last few years. Ask your accountant to help prepare the following statements in preparation for your small business loan application:

- Income Statement (also known as a Profit and Loss Statement)
- Balance Sheet
- Cash Flow Statement (optional but helpful)

Use these statements to figure out what's been going on from a top-line (revenue) and bottom-line (profit) perspective. (Because we're cash flow lenders, at Bond Street we care most about your business' profit/net income.)

Once you have your financial statements in front of you, you can answer these important questions, which affect your small business loan application:

1. Where are you making money?
2. What are your primary costs?
3. Are you profitable?

If the answer to #3 is no, you need to have a plan for how to get there. Where is the operating leverage in your business going to come from? Perhaps it's opening another store. If you're a retail brand, perhaps it's from securing better rates from your suppliers once you start ordering in bigger quantities. Understand how you're going to improve your profits, and you'll have a stronger case for getting a small business loan.

Prepare Your Documentation

You've analyzed your credit, your use case, and your financials. You are now mentally prepared for applying to a small business loan! With this knowledge, preparing mere paperwork will be a breeze, especially if you use our simple small business loan application.

While you'll need to understand the specific requirements of each lender, most will ask for the following documents:

- **Financial Statements:** Of course, lenders will need your income statement and balance sheet for at least two years of business operations.
- **Tax Returns:** Lenders also like to see at least one year of your business' tax returns. Many require two years.
- **Accounts Payable and Receivable:** With your accountant's help, prepare a full breakdown of both money your business owes and is owed.

Understand Your Offer

Your bulletproof small business loan application will naturally land you an offer. But how did the lender come up with this offer, and what does it mean? The lender uses your business financials to determine what size small business loan is right for you. Their offer includes an APR as well as an interest rate, both based largely on your credit score.

How High Is Your DSCR?

The [debt service coverage ratio](#) is a tool to assess whether you're applying for the right size small business loan. Calculating your DSCR helps determine whether a business can cover loan payments. It answers the question, "Will this business generate enough profit throughout the term of the small business loan to cover payments?" If the answer is no, all your profits will go to paying off the loan, or, worse, you won't be able to pay at all.

DSCR Calculation: The ratio of your net income to your annual debt obligations

To calculate your DSCR, divide your net income by the total debt (principal + interest + associated fees) you owe. If you run a business with a net income of \$100,000 and an annual debt obligation of \$50,000, your DSCR is 2. Your business's net income can cover its debt obligations twice over. At Bond Street, we require an average annual DSCR of 1.15 to approve a small business loan.

Note: Many people confuse DSCR with interest coverage ratio. Interest coverage ratio measures how comfortably a company can pay off its interest payments, not the entire debt obligation.

Interest Rates vs. APR

In addition to the small business loan amount, your offer will include two other numbers: your interest rate and [annual percentage rate \(APR\)](#). The interest rate is the percentage of the principal amount of the loan that the lender charges you to take out the loan.

APR represents a more complete picture. It represents a yearly average of the total interest you will pay, including fees and service charges. A small business loan with a low interest rate and big fees may have a higher APR than a small business loan with a higher interest rate and low fees. It's important to compare both numbers.

At Bond Street, we base the terms of our offer on your personal credit score, your business credit score, and your business financials. To get an offer for a small business loan with the lowest interest rate and APR, remember best practices for keeping your credit score high:

- Access your credit reports.
- Check for errors in the report.
- Pay off past-due debts.
- Pay off any tax liens.
- Keep your balance and utilization rate low.
- Diversify your credit mix, if you can.
- Consider hiring a credit monitoring service.

Accepting the Offer

You've analyzed your credit, assembled your financials, applied for small business loan, and like the terms you've been offered. Congratulations! You're ready to accept the offer. What happens next?

Once you've accepted a small business loan from Bond Street, we'll give you the full balance of the loan less the 3-5% origination fee (the only fee we have). Payments will occur semi-monthly, on the 1st and 16th of every month. If you pay off part of the loan early, you will effectively shorten the term of the loan, because that balance will not longer accrue interest. If you pay the small business loan off early in part or in full, we won't charge you a prepayment penalty. We'll be excited about your success! If your business continues to grow strongly 3-6 months after accepting a small business loan from us, you may be eligible for additional capital.

We want you to get the right small business loan, with the best terms, in a fair and

transparent way. From preparing mentally, to building a strong application, to getting more capital as your business grows, we want to give you tools that work well so your business can grow well.