

How to Find and Qualify for the Best Loan for Your Business

With so many business loans available to you these days, where do you get started? What loan product is right for you, and how do you qualify for it? We're here to walk you through the whole business loan application process—
from start to finish.



| | |
|---|-----------|
| Identify What You Need | 3 |
| What do you need a business loan for? | 3 |
| What can you actually afford? | 4 |
| How to Qualify for a Small Business Loan | 6 |
| The role credit plays in small business loans | 6 |
| How long have you been in business? | 9 |
| How much money is coming into your business? | 9 |
| How to Apply for a Business Loan | 10 |
| What financial documents will lenders need for a small business loan application? | 10 |
| What are the details of your business loan offer? | 12 |



- What are you planning on using the funds for?
- What can you actually afford?



[Debt-Service Coverage Ratio Calculator](#)

[Loan Performance Analysis Template](#)

Identify What You Need

What do you need a business loan for?

The first step of any business loan search is to determine what you need the financing for.

From bank loans, to inventory financing, to merchant cash advances... There are a lot of different types of small business loans on the market. Each loan out there serves a different set of business goals.

Need working capital to finance regular business expenses? A traditional business line of credit could make sense. Need to finance past due invoices? Invoice financing is the perfect loan for your business.

Some common business funding needs are:

- To start your business
- To quickly take advantage of a new business opportunity
- To expand your business
- To keep a cushion on your cash flow
- To manage your daily expenses
- To finance some equipment or inventory purchases
- And more

Pinpoint why you need the capital, and filter your search for the small business loan that will accomplish your funding goals.



What can you actually afford?

Once you've determined why you need the business loan, the next step is to think through how much funding you need—and most importantly, how much small business loan you can realistically afford.

One of the first questions lenders will ask you when you start your small business loan search is “How much are you looking for?”

Yes, we would all love a cool \$5 million. But instead of thinking of this question as how much you want or need, think along the lines of what you can actually afford. If you don't know the answer to that question, follow these steps.

Step 1

Calculate Your Debt Service Coverage Ratio

The best way to determine the small business loan payments your business can afford is to calculate your debt service coverage ratio. This is the number lenders will use to see how much cash you have to service your debt. This is also a number you can use to make sure you are comfortable with any potential debt payment. Your debt service coverage ratio is simply:

$$\text{Cash flow} / \text{Loan payment} = \text{DSCR}$$

You can calculate this on a monthly or annual basis. Here's how it works.

On average, how much cash flow (sales minus expenditures) do you have coming into your business each month? Let's say it's \$3,000. And how much do you project your monthly loan payment will be (both principal and interest)? Let's say \$1,000. This means you would have a debt service coverage ratio of 3, which is healthy!

All lenders are going to want to see that you have a DSCR of at



least 1. Anything lower than 1 shows that you don't have the cash flow on hand to make your loan payments.

However, most lenders will require that you have a DSCR of at least 1.5 or greater. But, don't forget, you should use this ratio for yourself too! What number are you comfortable with? Decide now. Let's say it's 2. Now, take your current monthly cash flow, divide it by 2, and use that number as you shop. Aim to find a loan that will allow your total monthly loan payment to be equivalent to that amount.

Step 2

Perform a Small Business Loan Performance Analysis

It is important to remember that the reason you are taking out a small business loan is to invest in your business.

Before taking on the debt, you need to make sure that you will in fact have a return on this investment.

Can you safely say that this debt will grow your business?

It's not an easy question to answer, so a great thing to do before committing to a loan is forecasting loan performance. By running a loan performance analysis, you can see how this small business loan will financially impact your business. It is also a great way to ensure you aren't taking out too large (or too small!) of a loan.

Step 3

Write Down Your Ideal Loan Payment

Now that you've taken a look at how small business loans can financially impact your business, and how to calculate your debt coverage ratio, decide on a rough estimate of a total monthly loan payment you'd be comfortable with. Keep this number close as you start your search.



- What is your credit score?
- How long have you been in business?
- What is your annual revenue?



Free credit report

How to Qualify for a Small Business Loan

The role credit plays in small business loans

Believe it or not, your personal credit score is one of the most important parts of the small business loan application. The way lenders see it is that they are lending money to the small business owner, so they want to ensure that you've got a strong history of acting wisely when someone has given you "credit."

The better your credit score, the better your chances of your securing an affordable small business loan.

A great thing to do before you apply for a small business loan is to pull your own credit report and check your credit score. You can do so for free at annualcreditreport.com. (Be wary of any other site that makes you pay!) By pulling your credit report, you now know exactly what lenders will be looking at.

What credit score will you need to qualify for a business loan? Well, it depends on the loan you're applying to.

Generally speaking, the longer-term and lower-rate small business loans will require the highest credit score. These are products like SBA loans, medium-term loans, and some business lines of credit.

On the other hand, borrowers with poor credit will have an easier



time qualifying for smaller, shorter-term products, like short-term loans, merchant cash advances, and some smaller business lines of credit.

In the end, online lenders will want to see a credit score of over 550, but you will receive better offers if your credit score is higher, say over 620 or preferably 640.

How to Analyze Your Credit Report

Have your credit report in hand?

The first thing you need to do is check your report for errors.

There could be things on your report that aren't correct or even applicable to you that are bringing down your score. This could be things like:

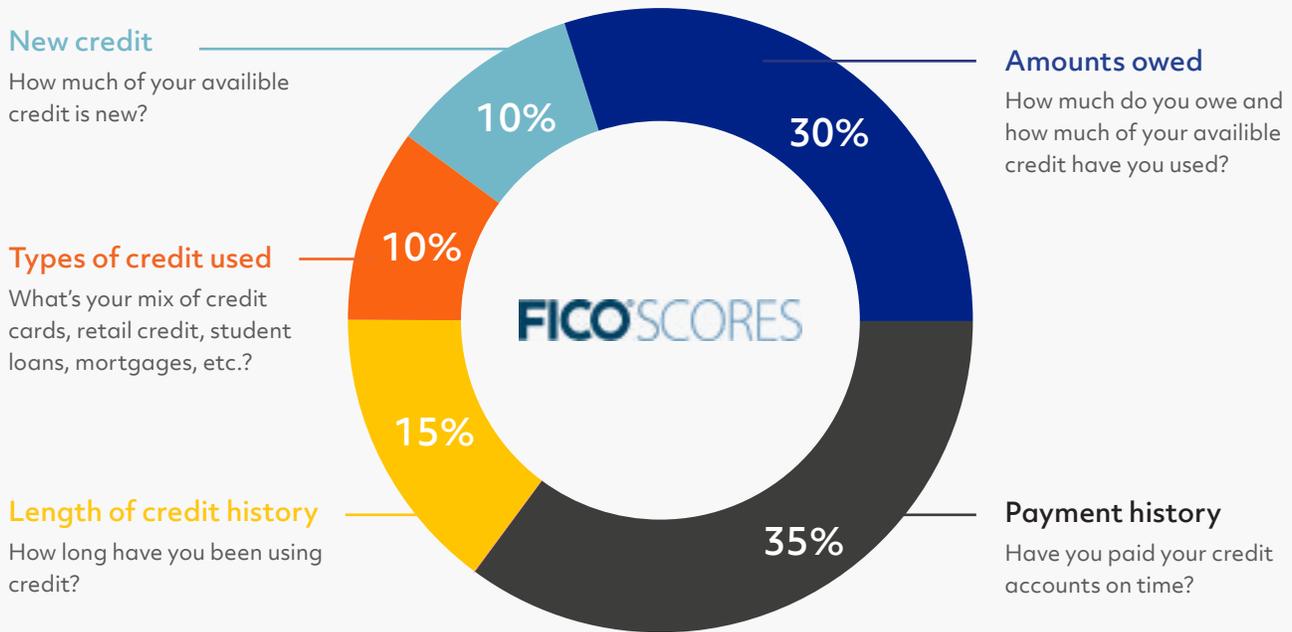


- Erroneous accounts or credit lines you never opened
- Erroneous judgments or collections
- Accounts, judgments or collections that were satisfied but are still showing as outstanding
- Judgments or collections you never knew about

To get this information removed, you need to first verify that the information is in fact erroneous. If it's a collections matter, you could start by tracking down the collection agency and asking them to let the credit bureaus know you've satisfied the debt. Or, if it is an unknown outstanding debt, pay it off and then ask the agency to contact the bureaus. For other matters, contact the credit bureaus directly. Send a dispute letter along with the supporting documents needed to verify the claim. The credit bureaus are obligated to investigate these matters and will usually get back to you with a result in around 30 days.

If you don't find errors on your report, but you think you can stand to improve your credit history, try to identify the areas where it needs the most work.

How is your credit score calculated?



As you can see, your payment history has the biggest impact on your FICO score. The best place to start improving your score is to make sure you're paying all your bills on time!

Suggested readings



How much can you really improve your credit score in one year?



Is there a minimum credit score for business loan eligibility?



How long have you been in business?

Another crucial factor in your qualification for a business loan is the amount of time you've been in business.

Why does this matter so much?

When it comes down to it, starting a business can be risky. Not all businesses will make it through their first year. And for this reason, lenders might be hesitant to work with a new business owner who might not have their doors open to make their loan payments in the future. Lending to a business that's been around for 2 or more years is a much less risky endeavor.

That's not to say you won't have options if you're a new business, though. Businesses 6 months to 1 year in business will have options with online lenders. Business owners with at least 2 years under their belt will have even more options available with online lenders, and might even qualify for a bank loan.

If your business is younger than 6 months, check out business credit cards as an option for obtaining startup capital.

How much money is coming into your business?

Lenders will also pay attention to your annual revenue when determining what you qualify for. This could be looked at as annual revenue, or broken down a little more as average monthly sales.

Either way, looking at how much money is coming into your business will help the lender determine how large of a small business loan you might qualify for. A lender wouldn't want to extend you a business loan with monthly repayments that exceed the amount you're bringing in each month.

In most cases, a lender will qualify you for a small percentage of your annual revenue to be sure you'll always have the cash on hand to make your loan repayments.



- Gather the documents you need to apply
- Carefully review your loan offers



[Business Loan Calculators](#)

[Balance sheet template](#)

[Profit and loss statement template](#)

[Business Debt Schedule](#)

How to Apply for a Business Loan

What financial documents will lenders need for a small business loan application?

Small business loans can have pretty extensive applications, depending on the loan product you are applying for.

Generally speaking, the lower the cost of the loan and the longer the term of the loan, the more paperwork that will be involved.

But no one lender is alike and each will have their own set of requirements. Here's an idea of some of the most popular documents needed for small business loan applications. Keep in mind—this is only a portion of what many lenders will ask for!



Business Bank Statements

Bank statements are a document you will almost always be expected to provide. For some lenders, you may just need 3 months. Others may ask for 6 or 12 months. Some will even ask for 2 years. Be prepared to pull whatever history length the lender asks for.



Balance Sheet

Many lenders will want to see your balance sheets or “statements of financial position.” They will most likely want to see a balance sheet that has been updated within 60 days. This is to give the lender a “snapshot” of the company’s recent financial health.



Profit and Loss Statement(s)

Many lenders will want to see your Profit and Loss Statements, also known as your Income Statements. They will most likely want to see your P&Ls from the last two fiscal years (also shown on business tax returns), as well as a company prepared Year-to-Date (YTD) version that has been updated within 60 days. This is primarily to determine the cash flow of the business and if it is able to meet existing and proposed debt obligations.



Business Debt Schedule

Some lenders are going to want to know if you currently have business debt and if you do, the payment details of that debt. To do this, they will ask for a debt schedule. This helps the lender determine your current debt obligations and if your cash flow is able to meet existing and proposed debt obligations.



Personal Tax Return

Most lenders will want to see your most recent personal tax return to verify your income. If you haven’t filed your taxes for this year, it might be best to do so before you apply, or at least have your extension paperwork readily available.



Business Tax Return

Most lenders will want to see your business tax returns from the last two fiscal years. If you haven't filed your taxes for this year, it might be best to do so before you apply. Lenders will use your business tax return to verify revenue, among other things. If you are a sole prop or LLC who doesn't file a separate business tax return then don't fret! Lenders will just want to see the forms and paperwork tied to your business, like a Schedule C, on your personal tax returns.

What are the details of your business loan offer?

With so many business loan options out there, it's crucial that you shop around for your absolute best offer.

So when you have a few different loan options on the table, it's important to think critically about which will be best for you—this means looking at each loan's cost, term, and repayment structure.

But when you are shopping small business loans, it can be very difficult to compare the various products on an apples-to-apples basis.

Why? Many lenders advertise the cost in "interest rates" but, truth be told, this doesn't offer a full representation of the price of the product. So, how can you compare products?

Ask Lenders for the APR

APR stands for Annual Percentage Rate. It is probably a term you are familiar with if you use a credit card. It represents the cost of a loan by including the interest rate AND any other fees you will incur to take on the loan. You may think you're getting a killer interest rate from a lender, but if they have a ton of hidden fees, they may not be the most affordable option. That's why APR is so important—it lets you compare loans across the board. APR can sometimes be difficult to calculate, so it is best to use an APR calculator.



Know What Loan Fees to Watch For

Now that you know fees affect APR, you're probably wondering what type of small business loan fees we're talking about. Here's a cheat sheet of fees you need to watch for with small business loans:

Origination Fee

An origination fee directly reflects the cost lenders incur to make a loan (think administrative work, etc.) It is often quoted as a percent of the principal.

Application Fee

Since it costs money to run credit and background checks, as well as invest the time to underwrite a loan, some lenders will charge you a processing/application fee to recoup that cost upfront, or wait until the loan is closed.

Guarantee Fee

If you're considering an SBA loan, there is a chance you might have to pay a guarantee fee. Why? The SBA doesn't directly make small business loans. Instead, they guarantee portions of loans, making it less risky for lenders to make loans to small business. But, to do this, lenders must pay a portion of the guaranteed amount to the government, so they often pass this fee directly on to the borrower.

Late Payment Fee

Probably not much of a surprise here, but with some lenders, if you're late on a payment, they'll charge you a fee. If they aren't automatically drafting from your account, be sure you've got a good internal reminder system in place so you never forget a payment!



Pre-Payment Fee

Considering paying your loan off early? Better be sure the lender doesn't have a pre-payment penalty! This fee is usually calculated as a percent of the outstanding principal at the time you decide to pay it off. Many lenders do this to ensure they recoup their costs from underwriting/servicing the loan.

Check Processing Fee

Many borrowers make their payments through ACH. If you prefer to send your payment in with a check, some lenders may charge you to process it. It is very important to discuss payment methods with lenders before signing on the dotted line.

Choosing Your Small Business Loan

You've done a lot of hard work to get this far! Now it is time to make the call on which business loan offers are right for you.

Ask yourself:

- Can I repay this loan?
- Am I comfortable with the payment, whether it is daily, weekly, or monthly?
- Can I confidently say this is the lowest rate I will find?
- Do I know all potential fees associated with the loan?

If you answer "yes" to all these questions, you should be ready to close your small business loan.

Still Need Advice?

We are always here to answer questions
support@fundera.com
1 (800) 386-3372