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**DISCUSSION PAPER #6**

# NINE WAYS TO BLOW THE LOAN

**ADDING CLARITY AND VISION**

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**9 Ways to Blow the Loan**

A self respecting banker with his eye perpetually on the bottom line, John Lau winces every time any representative of a high-tech start-up company walks into his office. It may be a good business; but it's just not his type of business, and the result is almost always a waste of time for both Lau and the would-be borrower.

"I don't know much about high-tech industries, explains Lau, senior vice president of international finance for the Pacific Bank, a San Francisco institution that primarily finances U.S.-Asian trade. "I don't have an appreciation for the issues and factors that will determine whether a high-tech company will do well or not."

Lau hammers home what should be obvious. "You have to find a bank whose lending expertise matches the type of loan you need. The prospective borrower has to do his homework. There are certain banks that are more likely to fund your venture. Go to them first, especially when you are in an industry where time to market is a matter of weeks or months. You shouldn't be wasting time with a bank that is probably going to reject you."

Elementary Errors. To help companies get to the right bank, make the right moves, ask for the right loan, Export Today has asked a cross section of bankers for their take on the typical mistakes an applicant -- whether from a big or small company -- makes when applying for a loan or line of credit.

The picture painted by the bankers doesn't always flatter their customers. Much of the feedback from the bankers focused on such elementary errors as wasting time with a bank that will almost definitely reject you.

At first glance, some of the mistakes would almost seem to defy common sense, such as not having a business plan (mistake number one). But when it comes to finance, it seems apparent that many companies that are smart in every other aspect of their business can make very foolish moves when it comes to dealing with banks, especially when a business deal or venture is on the line.

Other common mistakes can be attributed to the unwritten rules and mores of a banking industry that has undergone significant restructuring over the last few years, such as automatically assuming a bank understands your industry or assuming your banking relationship will remain the same after a merger (mistakes number two and three). It's not a question of poor organization, but the result is the same in the end -- rejection. Missed opportunities, as to be expected, also show up on the list, such as overlooking unorthodox types of collateral (number six). So does the unexpected, which is not as much of a rarity as one might expect in the highly regulated and staunchly conservative banking industry (see numbers four and five).

To be sure, the responsibility for a good banking relationship should not lie entirely with the petitioner. "A bank has to communicate with its clients to find out what its needs are," Lau says. If it doesn't, he says, that bank may find that some other institution has offered its client a bigger and cheaper line of credit.

For borrowers, such a happy scenario is not completely unreasonable in today's flush economy -- unless that is, they make one of the following all-too-common mistakes.

**1. Walk in With No Business Plan**

As basic as this tip might seem (check out chapter 1 of any college freshman's business 101 textbook) the fact is that an extraordinarily large percentage of companies simply do not have business plans. According to a PwC survey last year, roughly one-third of all rapid-growth firms fall into this category. "If there is any one mistake I could warn companies about, it would be this," says Pacific Bank's Lau.

Business plans must be in writing, Lau says. At a minimum, they must include a balance sheet and income statement. But the plan should also articulate company goals and objectives. At the very least, such a plan will give a banker confidence in your company. It will also avoid wasting time later, as he or she will want this information anyway.

Most fundamental, a good business plan is the basic prerequisite for a company to be able to clearly define its funding needs, Lau says. "Do not ask the banker how much money you can obtain based on your financial statements," he says. Such a request, at best, suggests the borrower didn't do his homework. At worst, it can ruin the borrower's basic creditability. A good business plan will also prevent the borrower from guessing wildly about funding needs and asking for too much or too little money for the proposed venture.

All plans should include supporting statistics and projections, along with a realistic plan outlining how the money will be paid back. Not taking care of the latter, needless to say, is a sure-fire way to squelch any loan petition.

**2. Assume it's Business as Usual if your bank Merges or is Acquired**

It is very common, after almost any M&A activity involving a bank for customers to find that their banker has been shifted to another department or has left the bank altogether. Worst of all, a merger may mean the new bank is no longer so enthusiastic about the same lines of business as it was before.

Reductions in staff are a common side-effect in most mergers in most industries. Companies usually lay people off to realize the synergies of the merger, and to eliminate duplicate functions. In the banking industry, other unsavory byproducts of a merger can include new more rigid lending requirements and new products designed to fit only a standardized mold. Clashing corporate cultures between the two sides in a deal can also end up letting even long-term customers fall through the cracks. Problems were reported, for instance, after the recent merger between Deutsche Bank, a European bank known for its conservatism and stability, and U.S. based Bankers Trust, whose hallmark has been innovation and risk-taking. A post-merger internal bank study released to the press revealed that cultural differences between the two banks had "led to insecurity and foot-dragging in some quarters."

The key mistake borrowers make during such upheavals is not staying in touch with their banker, says Lawrence Frohnhoefer, first vice president of MTB Bank. "You should be aware of what is going on with your banker and make every effort to maintain continuity with him. Get a feel from him about what is going on and if you might get lost in the shuffle... It may be the case that the squeaky wheel gets the oil," he says.

Not that all M&As are necessarily bad for customers, Frohnhoefer emphasizes. A company may well find that the enlarged institution actually offers more services than before. "Not to leverage these new capabilities just because they weren't part of your old' bank is also a mistake," Frohnhoefer says.

**3. Assume Your Bank Knows Your Industry**

Banks have evolved dramatically over the last decade. No longer are they mostly community-oriented generic institutions serving a relatively small and rather amorphous customer base. The rapid consolidation within the industry has led to much bigger banks, able to offer much greater degrees of specialization. Even so, explains Rob West, senior vice president of CoBank, a Colorado-based lending institution that specializes in telecommunications, that doesn't mean your bank understands your company's needs as well as another might.

Few banks will turn away a good prospect with a healthy balance sheet. But West advises companies to shop further. "It is only prudent for a borrower to work with someone who understands their business and won't get scared and pull the plug if something happens that they don't understand." As new industries such as e-commerce emerge ever more quickly, such a scenario is becoming ever less rare. In some cases, even a healthy balance sheet may not be enough for the more conservative institutions. "Only a handful of national banks will finance telecom ventures," West says. Besides CoBank, he says these include BankAmerica, Toronto Dominion, CIBC, Fleet and First Union.

One upside to this more specialized focus is that finding the right bank to match your expertise is not a problem -- if your company has any weight in your industry. "Actually they will usually find you," West says. Another plus is that once a company finds the right bank, it will be able to count on a greater variety of vertical product lines geared to that industry, West says.

**4. Assume Your Loan Officer is Senior Enough to Approve Your Line of Credit**

This is another very basic mistake that many companies still make in their eagerness to fund a particular transaction or get a good deal underway. Basically, says Pacific Bank's Lau, "the prospective borrower has to discern how senior the lending agent is. If he says yes,' is there somebody above him that can say no'?" The consequences of an initial, but erroneous acceptance will likely prove very costly in mid-transaction.

**5. Assume Your Loan Officer is Following Orders**

There may be times when a lending agent takes on your business even though he or she is fully aware it doesn't fit in with the bank's lending philosophy. Most companies are not on their guard against such an event., CoBank's West says "A loan officer deliberately pushing a mismatched loan through is not something most companies would expect."

But it can happen. While most banks have a rigid hierarchy that will usually prevent a rogue lending agent from going on a spree, "sometimes you will find that an account officer might try to do something or create a niche for himself, but not have the backing of senior management," West says. Lending agents, he adds, are essentially sales people, usually with quotas.

At face value this may be of negligible interest to borrowers (after all, it's the loan officer's career not theirs) but down the road it could have a suddenly disruptive affect on a line of credit. "A loan officer with a quota might push your loan through the approval committee," says Pacific Bank's Lau. "Yes, you might get the loan, but he might have misrepresented you to do so. Two years later, when he is gone that could come back to haunt you."

Whether your bank contact is simply misguided or deliberately building a lending portfolio contrary to the bank's lending mission, the best protection says West, is to insist on "introductions to senior management... You should expect the account officer you are working with to introduce you to his boss and even his boss's boss, perhaps even the credit people." Another step, he says, is to read the bank's annual report. "It will describe where the bank's strengths are, what areas they are developing, what they are targeting."

**6. Overlook Assets that Can be Used as Collateral**

Most savvy businesspeople know that company assets are not limited to physical goods and real estate. A skilled labor force is an asset, as is a company's trusted name. Neither of these are worth a dollar at a bank, however. But companies that automatically assume the only collateral are objects that can be seen or touched may be missing valuable funding opportunities, says Paul Weaver, global technology leader for PwC. Patents and other intellectual property can be used as collateral, as can income streams such as licensing fees, he says.

Not all banks will accept such forms of guarantees, of course. But the industry is slowly becoming accustomed to less orthodox collateralization, especially with the huge growth of high-tech (and low physical asset) firms. "Most of these firms don't have hard assets," Weaver says. "So they have learned to think creatively when it comes to collateral."

**7. Take 'No' for an Answer**

Walt Trask, vice president of structured finance at Wells Fargo HSBC Trade Bank, tells of one client who kept shopping from bank to bank until he found one that was willing to structure the deal exactly as he wanted. "All the banks were proposing discounting" as a way for the borrower to design the loan, he explains. But the client wanted to have interest charged in arrears, an unusual design, but one that would meet the client's requirement for as much cash up front as possible, Trask explains. Wells Fargo HSBC finally agreed to the client's wishes, and the deal went through.

"Everything is negotiable," Trask says. This fact, however, is often overlooked by would-be borrowers sitting hat in hand in a loan officer's office. "There is so much money available today," PwC's Weaver says. "Companies make a mistake in not negotiating with their banks." Even interest rates are on the table, he says. "Some banks will take an equity interest in lieu of some differential in interest rates. Cash is cash, and if you can save money giving out small amounts of equity, you may be better off," Weaver says.

Another possibility is to negotiate a lower interest rate, in exchange for giving the bank a certain number of warrants to buy stock. "For most middle market companies holding on to cash is preferable to holding on to equity."

Most important, Weaver advises, don't underestimate your bargaining potential. "Companies are in the driver's seat, as there is much less need for bank financing today." Options for mid-market companies now often include everything from venture money to IPOs to angel lenders,' though such sources can prove to be much more expensive.

**8. Assume Your Bank offers all the Services you Need**

Never assume a bank offers a full complement of services, no matter what their marketing materials may say. "A lot of banks tout they are international, but it means different things to different banks," says Wells Fargo's Trask. "The customer must satisfy himself that what is being offered on paper is deliverable in reality." Trask advises prospect clients to "take a tour of the international offices. Speak with someone other than the sales person, perhaps a manager. Satisfy yourself that you will get what you were promised you'd get."

A related point, says CoBank's West, is to make sure your target bank actually has the capacity to meet your financing needs. "The amount you need to borrow may exceed the capacity of the bank," he warns, especially if it is a smaller bank serving mid-market customers. In the telecom industry especially, this can quickly become an issue. Acquisitions, new licenses, digital switches and other technology can be very expensive, West says. For loans of $30 million or more, a syndication is usually the best answer, he says. But can your bank take you to the syndication market?


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**9. Fail to Take full advantage of the services a bank offers**

When the euro falls or the real is devalued, some companies have less to lose, having engaged in sophisticated hedging techniques to protect their bottom line. Others, often feeling overwhelmed by the need for yet one more purchase decision, simply opt to ride the fluctuations with no protection. Usually, this is totally unnecessary, says Keith Cheveralls, a managing director of global foreign exchange at BankBoston. If there is any market that your bank is likely to understand, it is the foreign exchange market. After all, Cheveralls says, a bank's business is money.

Too few companies, however, avail themselves of the expertise available in most banks, focusing instead on specific FX transactions. "It is our obligation to offer advice to customers to make intelligent decisions," Cheveralls says. It is not, however, the obligation of the customer to listen.

By Erika Morphy writing in the Journal of the Federation of International Trade Associations

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