EMIRATES Business24|7

Buddy, can you spare me a dirham?

By Tom Addyman on Monday, December 21, 2009

This week, I'm going to try and make all our lives a little easier. My job is to assess small- and medium-sized enterprises (SMEs) and where appropriate lend them money. I have to make sure that the business has a good chance of success and will have the ability to repay what it has borrowed. It's a win-win situation really, as there's just no point in borrowing what you can't afford to repay.

The conditions over the past two years have meant that a lot of small businesses have had to seek credit in order to keep their heads above the water, and we are now starting to see those that are likely to stay afloat. We're still hearing a lot about the green shoots of recovery and sentiment is, by and large, starting to become a bit more positive. Some lenders are starting to extend the availability of credit, but before rushing out to ask for a loan it's worth doing a bit of preparation. So, what do you need to cover as part of your preparation?

Whilst every lender will have its own approach to determining the viability of an SME credit request, there are, in general, four main areas that they will focus on. These are; the nature of the business, the people running it, the performance of the business and the purpose of the funds that are being borrowed. I'll discuss each of these in turn.

The first thing that a lender will want to understand is the nature of the SME that it is looking to lend to. Here it's really important to be able to clearly explain the purpose of the business and what it does. Lenders look for clarity of focus and will get turned off by a business that can't demonstrate expertise in a particular field. It's also important to be able to convey how the business adds value to its end customers. After all, it's the value-add that makes customers come to the business in the first place and keeps them coming back again and again.

In the context of helping the lender understand your business, it's important to be able to explain the position it enjoys in its chosen market. Here, you should look to be able to explain the nature of competition and the bargaining power that the business has with its suppliers. A business which has power over its suppliers and which has strong distribution capability will be more likely accepted than one which is in a weaker position. Where the business benefits from a unique competitive advantage, take the opportunity to explain this. It could be that you have sole distribution rights on a product, have a superior technology or process than your competitors, or have protected intellectual property that the business utilises.

Once comfortable with its understanding of the SME, lenders will then start to look a bit more closely at the people involved in the business. First and foremost, a lender will look at the shareholders in the business, particularly those who are involved in the day-to-day running of the company. Having a sizeable shareholding and being employed as a member of the business demonstrates a vested interest in the success of the company and helps convey an active understanding of the issues being faced by the business.

For key shareholders, lenders also look at what they have done with drawings or dividends from the business. Shareholders who re-invest in the company or use funds to acquire tangible, immovable assets in the UAE are generally viewed more favourably.

When looking at the people involved in an SME, and in particular the senior management team a lot of emphasis is placed on track-record and experience. Where it exists, try and demonstrate the accomplishments that members of the senior team have enjoyed at other companies or in other countries. Where technical skills are vital to the business bring these out when discussing the proposition with your lender.

As with shareholders, a management team that is incentivised in line with the success of the company can be viewed in a more favorable light. One final thing to bring out is succession planning, particularly for key roles or in cases where members of senior management are planning on leaving the business in the next few years. Lenders look for stability, certainty and above all a plan.

Having got comfortable with the business and the people involved, a lender will then take a hard look at the performance of the business and its plans for the future. For a business that has been going for any length of time, it's important to be able to produce audited financial statements.

These give the lender comfort that the performance of the business has been independently verified and that appropriate financial reporting is in place. Even if you have no need to produce audited accounts and presently have no borrowings but plan to do so in future, consider getting audited accounts produced now. Lenders will always be more willing to lend if historic data is available. It's good too to be able to present up to date financial and management information. Not only does it help explain the current performance of the business, it also shows that management are in control of the business and know what's going on.

In reviewing the performance and plans of the business, very often a lender is looking for stability. Consistent, steady growth is very often a better proposition than a company which experiences rapid and unsustainable growth. Likewise, lenders like to see positive cash-flow being generated from operating activities and to see that there is commitment and confidence in the business, demonstrated through profits being retained in the company. If the business has had setbacks, try and demonstrate what steps have been taken to mitigate the impact. Foremost, a lender is looking for confirmation that the borrower knows what they're doing and are in control of the situation at any given time.

The final thing a lender will look at is the purpose of the lending and how it will be repaid. Very often I see lending requests to fund future growth. Here it's important to be convincing on the viability of growth, particularly in a recessionary environment. If say you're looking to increase your manufacturing capacity through the purchase of new equipment, be clear on where the orders will come from and how you'll support the increased working capital requirements. If you can't justify the use of the funds, then the chances of success will be much lower. Be doubly sure on your ability to meet repayments as your lender will give this particular scrutiny. It's also good to be confident and clear on how the business would respond if faced with a stress scenario (say a downturn in sales). It's because of the risk of not being able to repay, that many lenders will ask for security to be given. It's usually more favourable to be able to offer security up-front.

So, in summary, when looking for funding to support your business, think carefully about how you describe the business and the people who run it. Show that the funding is required and that there is confidence that it can be repaid even if things go against plan.

- The author is a Managing Director of Commercial Finance at Gulf Finance. The views are his own