The Five C's of Credit

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Talking to a banker can seem difficult. I guess we don't feel all that comfortable seeing someone once in a while, especially when they hold our future in balance. A good strategy for dealing with a lender is to understand the qualities they are looking for. The following five areas are what most lenders consider. Before going to the lender it would be a good idea to make an inventory and itemize the qualities in the areas listed below.

- **Character.** In this area the lender is looking for such things as training and knowledge, experience, financial competency and plans for the future.
  - Training and knowledge are examined in terms of education and understanding of the industry. As a farm manager you are called on to make decisions in the areas of production, marketing, finance and human resources.
  - Experience cannot be under rated. Direct experience under many different managers as well as in other industries gives a strong basis to be a good manager. It also gives a manager the resources often required when times get tough.
  - Financial competency means that you can understand the importance of records and record keeping as well as how to use them to your advantage. Nothing frustrates a lender more than a person who doesn't have a clue about the finances of the business. In order to understand the business, records and current records are necessary.
  - Plans for the future indicate an attitude that will allow a lender to size up an operator. Are the plans well thought out and logical? What are the shortcomings? What are the strengths?
  - The area of character can go a long way to help an operator achieve their goals. Remember to sell yourself at all times so the lender can have confidence in your abilities.
- **Capacity.** This refers to the ability to service the debt, replace assets as they wear out, provide money for living and possibly expansion.
  - In order to do these items the business must have liquidity. Being liquid means nothing more than to have cash or the ability to generate cash to meet ongoing commitments and expenses.
  - Liquidity can also be referred to as working capital and is the difference between current assets and current liabilities.
  - In order to have healthy liquidity we must make sure that cost control is exercised. Income must ,over time, be greater than expenses. Always remember that you must strive to get the most bang for your buck and that you can only spend that buck once.

- **Commitment.** Here a lender looks at the operator's financial commitment as well as how clearly he is personally committed. Personal commitment to the business includes lifestyle choices. Farming is not a turnkey operation and it takes someone of intelligence, ability and the desire to do a good job to be in charge at all times.
  - Financial commitment is measured by the amount of money the owner is putting up as compared to the lender. In farming it is rare for a lender to put in more money than the borrower (50% debt to asset ratio).
  - Even a huge net worth (assets less liabilities) may not be acceptable if the lender is more at risk than the borrower. As farms get larger, managers better and cash flows stronger lenders will hopefully accept a lower percentage stake from the borrower.
- **Collateral.** This is also referred to as security. As a borrower you do not want to give the lender all your collateral if possible. This limits your ability to act without the lenders blessing. This could limit your ability to make other borrowing decisions on your own and reduce the speed by which you may need to take advantage of certain situations.
  - The type of security determines the time it might take to sell in the event of bankruptcy. Lenders do not want to be business operators. Even if plenty of security is available, the time required to sell it can cause problems in the lenders mind.
  - A healthy and strong cash flow is certainly something that lenders will prefer to collateral that is hard to liquidate.
- **Conditions.** Even if all criteria are passed, conditions may prevent a lender to forward a loan. Conditions generally include markets, consumer trends, economic predictions and as well environmental considerations.
  - How accessible and secure is the market?
  - Even if a market seems strong and secure, what are the consumer trends that may affect the business?
  - We live in an increasing global economy. World wide as well as local economic outlooks are taken into account by the lender before he forwards a loan.
  - Ever more today environmental restrictions, possible damage to the environment and past environmental damage can all prevent a loan.
  - The positive thing that a borrower must keep in mind is that a lender needs to lend money in order to make money. The money in an account is a liability to the lender while being an asset to the depositor.
  - A lender will decide if a loan is feasible, profitable and acceptable to you and the lender.
  - Good communication skills to express goals and objectives to your lender and to explain how your plan is feasible and profitable will generally result in acceptance by the lender.

In closing, I would invite you to contact me at CCE in Franklin and St. Lawrence Counties if I can be of assistance to you. We are able to help you with planning and analysis of your operation as well as help you prepare the necessary financial statements. It is always good to start off on the right foot with your lender. The relationship will be for a long time.