FINANCIAL POST

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# Small business owners should think of banks as a source of liquidity, not capital

Mary Teresa Bitti | October 8, 2014 8:00 AM ET

**Fotolia** *Understand your market, what your business is, who your customers are and your value add. With that knowledge, determine the implications of those factors on your cash flow needs.*

A sane and sober environment. That's how Andrew Penny, president of Ottawa-based business advisory firm Kingsford Consulting, describes the lending climate for small business owners. "While there's lots of capital available, everyone — banks and private investors — is reluctant to let it out," Mr. Penny said.

"The level of confidence in the economy is shaky at the moment. That said, a good project will always get funded."

There is a caveat, though: You have to make a good pitch, particularly when it comes to approaching a bank for business financing. The key to making an effective pitch is to understand the bank's perspective, said Brad Cherniak, partner at Sapient Capital Partners, a business advisory firm in Toronto.

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"Most entrepreneurs don't appreciate what banks do, viewing them as a source of capital. That's not what they do at all. They are a source of liquidity and a way to reduce your cost of capital," he says. "It's an important distinction."

Simply put, where an investor wants to understand the upside of a business and how to grow it, banks are looking for a steward of their capital, someone they can trust. "They are not putting their money at risk. Rather, they are renting it to you," Mr. Cherniak said.

"They want to have confidence that you know what's going on but it's not the same dialogue you would have with an investor."

With that perspective, here are a few key principles to guide your meeting with bank loan officers:

**Build a list of financial institutions you may want to approach based on areas of focus** "Some may feel over exposed in manufacturing, while others may be under represented in the ICT sector. Find out what sectors they are interested in funding," Mr. Penny said.

"Once you understand how each of the banks is playing the game, rank them and pitch No. 3 to begin with to practise and then work up to the one you really want to deal with."

**Be clear on your cash flow needs** Understand your market, what your business is, who your customers are and your value add. With that knowledge, determine the implications of those factors on your cash flow needs.

"Banks want to know you have a handle on the cash requirements of your business," Mr. Cherniak said. "There is an adage that a bank is a place you go when you don't need money. It's true. They don't want you to come to them and say you're going to hit the wall in three months if you don't get the loan.

“Bank debt is a way to add cash into the system at a lower cost than venture capital or doing a stock issue. If you go into a bank meeting with a consolidated forecast for the next six months, 12 months, two years and how much capital you will need to achieve those numbers, then you have a leg up.”

**Have a business plan** It tells a story — what you are going to do, how you are going to do it, who is going to help, the challenges you will face and what resources you need to get it right,” Mr. Penny said.

“You also have to indicate you have thought about what can go wrong. In the business plans we write I always include a risk management section so if someone can think of that nasty question, you can pre-empt it by having it already built into your plan. If you go in with a professional document, it will significantly improve the probability of getting a loan.”

**Establish an advisory board** Banks like to see entrepreneurs who have help, a team that can provide insight. “They don’t want you labouring alone and getting overwhelmed,” Mr. Cherniak said.

**There are other ways to get money** You can work with a lead client account to help finance the down payment on equipment to build out a new product line; if you have a good relationship with your suppliers, you can negotiate term credit agreements; or you can sell your expertise ahead of delivering a more refined product.

“You don’t necessarily need money from a bank or investor to cover cash flow needs,” Mr. Penny said. “There are alternatives and using them leaves room for financing down the road.”