



Obtaining Business Financing



Helping businesses start, grow and prosper!

Friday, October 24, 2025

Obtaining Business Financing - General Guidelines

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OBTAINING BUSINESS FINANCING

Obtaining Business Financing

Understanding the factors that influence your ability to obtain financing is critical to successfully funding your business. This guide serves to demystify the process and priorities of lenders as you apply for financing. If throughout this guide you believe you may not qualify based on the information, that is okay! A. You are well within your rights to apply regardless, and B. You now have a new goal of addressing the hurdle that's in your way and once you've done that you can consider applying.

In this guide we'll address the following:

The 5 C's of Credit:

1. **Character:** Lenders assess a borrower's reputation and reliability. A strong credit history and a high credit score reflect positively on the borrower, indicating a likelihood of timely repayment.
2. **Capacity:** This measures the borrower's ability to repay the loan based on their income and existing debt. Lenders look at the debt-to-income ratio to ensure the borrower can handle additional debt.
3. **Capital:** Lenders evaluate the borrower's financial assets and net worth. A strong capital base indicates financial stability and reduces the lender's risk.
4. **Conditions:** External factors such as economic conditions and industry trends are considered to gauge the borrower's financial stability.
5. **Collateral:** This refers to the assets a borrower pledges to secure the loan. It provides the lender with a form of security in case the borrower defaults on the loan.

Commercial Loan Evaluation Factors

Lenders consider a combination of personal and business factors when evaluating loan applications:

- **Applicant Factors:** Credit rating, arrest record, cash availability, net worth, income, and management experience.
- **Business/Financial Factors:** Profitability, gross sales, asking price, market position, financial ratios, and detailed business plans.

Loan Options

Different types of loans cater to varying financial needs. Options include personal loans, mortgages, business loans, and lines of credit. Each loan type has specific terms, interest rates, and repayment schedules, so it's important to choose the one that aligns with your financial situation.

Who Do I Talk To?

When seeking a loan, you have several options:

- **Big Banks:** Offer a wide range of loan products with flexible terms for well-established businesses.
- **Local Banks/Credit Unions:** Provide personalized service, often more accessible for small businesses or startups.
- **Community Development Financial Institutions (CDFIs):** Focus on underserved communities, offering more favorable terms and accessibility.

The Loan Process

The loan process involves several steps, from initial conversation and document submission to underwriting and approval. Understanding the process and being prepared with the necessary documents, such as a business plan, financial projections, and tax returns, can significantly increase your chances of loan approval.

By familiarizing yourself with these qualifications and processes, you can better prepare for your loan application and increase your likelihood of securing the financing you need.

LOAN QUALIFICATIONS

The 5 C's of credit are fundamental principles used by lenders to evaluate the creditworthiness of potential borrowers. These five factors—Character, Capacity, Capital, Collateral, and Conditions—provide a comprehensive framework for assessing a borrower's ability to repay a loan. Character refers to the borrower's reputation and track record for repaying debts. Capacity assesses the borrower's ability to meet their debt obligations based on income and current debt levels. Capital evaluates the borrower's net worth and financial assets. Collateral examines the assets or guarantees that they can secure the loan. Conditions consider external factors like economic conditions and industry trends that might impact the borrower's financial stability.

Together, these elements help lenders make informed decisions about extending credit and managing risk.

Character – Borrower's Trustworthiness – Credit Score

Client's Credit Score: _____

Character refers to a borrower's reputation and trustworthiness in managing financial obligations. Lenders evaluate character by examining credit history, past interactions with creditors, employment history, and personal references. A strong credit history with timely payments and responsible debt management reflects positively on a borrower's character, suggesting reliability and integrity. The average credit score needed to obtain a loan when starting a business is usually above 650, but this varies from lender to lender. Essentially, the character assesses the likelihood that the borrower will honor their commitments and repay the loan as agreed.

Capacity - Ability to Repay the Loan – Business Cash Flow

Client's DTI: _____

Capacity measures a borrower's ability to repay a loan by evaluating their income and existing debt obligations. Lenders assess capacity by examining the borrower's debt-to-income ratio, employment stability, and income sources. It is calculated by dividing the borrower's total monthly debt payments by their gross monthly income. The resulting percentage provides insight into the borrower's overall financial health and their capacity to take on additional debt. To be considered for a loan a client's small business Debt-to-Income (DTI) ratio should be below 50%, but a strong DTI ratio that gets accepted frequently is a DTI ratio of 36% or less. This accounts for monthly debts including debts of personal as well as business expenses. If you are a startup, gross monthly income **MAY** come from financial projections, however lenders strongly prefer stable predictable income.
(Sum of all monthly debts ÷ gross monthly income)

Capital – Level of Commitment to the Project – Money Down

Client's Funds for Down Payment: _____

Capital refers to the financial assets and net worth a borrower possesses. Lenders evaluate capital to determine the borrower's financial resilience and stability. This includes assessing savings, investments, real estate, and other assets that could be used to repay the loan if income sources become insufficient. A strong capital base indicates that the borrower has a solid financial foundation, reducing the risk for lenders. It also shows the borrower's commitment to the loan, as having significant capital often means they have a vested interest in maintaining their financial health and meeting their debt obligations. On average a client will generally need 20% of a down payment to fund the loan.

Conditions – Health of Economy and Industry of investment

Client's Case for Industry: _____

Conditions refer to the external factors that can influence a borrower's ability to repay a loan. These factors include the overall economic environment, industry trends, interest rates, and the specific purpose of the loan. Lenders consider conditions to gauge potential risks that may impact the borrower's financial stability. For instance, a stable economic climate and a thriving industry can positively affect a borrower's ability to meet their obligations, while an economic downturn or a struggling industry might pose challenges. By evaluating these conditions, lenders can make more informed decisions and tailor loan terms to mitigate potential risks.

Collateral – Assets Purchased with Loan

Client's Case for Collateral Assets: _____

Collateral refers to the assets that a borrower pledges to secure a loan. This serves as a form of protection for the lender, ensuring that if the borrower defaults on the loan, the lender can seize the collateral to recoup their losses. Common types of collateral include real estate, vehicles, equipment, and investment accounts. The value and liquidity of the collateral are crucial factors in the lending decision, as they directly impact the lender's ability to recover the loan amount. By providing collateral, borrowers demonstrate their commitment to the loan, which can also result in more favorable loan terms, such as lower interest rates or higher loan amounts. Lenders require 100% of the loan to be reinvested into collateral

COMMERCIAL LOAN EVALUATION FACTORS

The following factors indicate the "ideal" situation for going to a bank for a small business loan. If you cannot respond "yes" to all of these factors, it does not mean that you cannot obtain financing. Lenders look at these factors in the aggregate. In other words, if you are weak with respect to one factor but strong in another, your overall situation may allow you to obtain a loan.

Applicant Factors

- Credit: Excellent ratings and no personal or business bankruptcy.
- Arrest: No arrest for fraud, theft, embezzlement, or drug/alcohol abuse.
- Cash: Applicant has 20% or more of cash needed for the project.
- Net Worth: Applicant has net worth (for use as collateral) greater than 100% of the loan amt.
- Income: Applicant does not need to draw income from the project for a period of time. Fixed payments per month (house, car, credit cards) do not exceed 40% of net income. (A working spouse who can cover living expenses is highly desirable. Must provide three years of tax returns to verify income and standard of living.)
- Experience: Applicant has three to five years' general management experience as a minimum, and, preferably, one or more years' industry specific experience.

Business/Financial Factors

A. Buying an existing business:

- Profitability - must have good track verified by 3 years financials and tax returns.
- Gross Sales -- should be in excess of \$100,000 per year.
- Asking Price -- should have a thorough valuation, including appraisals.
- Market Position -- should have a good market position.
- Financial Ratios -- should compare favorably to industry standards.

B. Starting a new business:

- Market-- must have a thorough market analysis.
- Location -- must be a clearly good location.
- Experience -- applicant must have excellent experience.

C. Expanding a business:

- Profitability -- good track record.
- Cash Injection -- must have at least 10% cash needed.
- Financial Ratios -- better than industry standards.

C. Any business:

- Liquidity ratio, $\frac{\text{Current Assets}}{\text{Current Liabilities}}$ --1.0 or better.
- Coverage ratio, $\frac{\text{EBITDA}}{\text{Interest Expense}}$ --1.2 or better.
- Debt/equity ratio, $\frac{\text{Total Liabilities}}{\text{Shareholder's Equity}}$ --3 or better.
- Detailed business plan, including three years pro forma statements.

LOAN OPTIONS

When it comes to financing major purchases or investments, understanding your loan options is crucial. Banks offer a variety of loan products designed to meet different financial needs, from personal loans and mortgages to business loans and lines of credit. Each type of loan comes with its own set of terms, interest rates, and repayment schedules, making it essential to choose the one that best aligns with your financial situation and goals. By exploring these options and consulting with financial advisors, you can find the most suitable financing solution to achieve your objectives while managing your financial health effectively. Below are screenshots explaining the different loan types along with what they are used for.

TYPES AND USES OF LOANS

SHORT TERM

LOAN TYPE	USE OF FUNDS	SECURITY	INTEREST	MONTHLY PAYMENT
Credit Cards	Most common form of short term credit. Used for everyday purchases such as supplies and other necessities.	Unsecured	Variable. 10-40%	Monthly, 2-3% of average balance.
Lines of Credit	Short term working capital; seasonal purchases	Secured	Fixed or variable. 1-4% above prime	Interest monthly, principal at maturity. In some cases, principal and interest monthly.
Letter of Credit	Used in connection with international sales transactions to expedite shipping and payment. If seller demands payment by letter of credit, the buyer must arrange with its bank to issue letter of credit	Secured	Fixed. 1-3% above prime	Depends on circumstances.
Asset Based	Cyclical and short term working capital. Used by businesses that provide credit to other businesses.	Secured (usually by inventory and accounts receivable)	Usually variable. 1-6% above prime	Monthly. Dependent on changes in inventory and accounts receivable.
Factoring	Company sells accounts receivables at a discount to a factoring company for cash. Company can get 80 -90 percent of invoice's face amount. Once collected by factor, the company will receive remainder less fees and interest	"With- or Without-Recourse." With-Recourse: Factor is not responsible to collect delinquent receivables. Without-Recourse: Factor has to collect delinquent accounts. Without-Recourse agreements are more costly than With-Recourse (high risk, high premium).	3-5% Note: Can be as high as 60 % annually.	Dependent on changes with accounts receivable sold.
Bridge Loan	Used to transition from the end of one loan to the start of another.	Secured or unsecured	Variable. 1-2% above prime	Paid at end of period or consolidated into next loan.
Merchant Cash Advances	Short-term working capital.	Unsecured	Variable 10- 40%	A percent is deducted from future customer credit card transactions.

LONG TERM

LOAN TYPE	USE OF FUNDS	SECURITY	INTEREST	MONTHLY PAYMENT
Term Loan	Most common general purpose loan used for business expansion purposes.	Secured	Usually variable 1-3% above prime. Loan fees 1 - 2% of loan amount.	Principal and interest monthly
Term Loan with SBA Guaranty: 7(a) loan Guaranty Program	Used for working capital and business expansion. SBA guaranty provides the small business owner with greater access to capital.	Secured	Usually variable. 2-5% above prime. Loan fees 3-8% of loan amount.	Principal and interest monthly
Equipment Leasing	Alternative to term loan. Easier for small business to secure since equipment serves as collateral for loan.	Secured	Market rate	Monthly
Commercial Real Estate loan	Acquisition of commercial real estate.	Secured	Fixed and Variable. 2-4% above prime.	Principal and interest monthly
Commercial Real Estate loan with SBA Guaranty: Certified Development Company (504 Loan) Program	Acquisition of commercial real estate. SBA guaranty provides the small business owner with greater access to capital.	Secured	Fixed and Variable. 2-4% above prime.	Principal and interest monthly
Micmloan	Start-up costs and working capital. Loans usually will not exceed \$25,000 and will mature in 12 - 60 months.	Secured or unsecured	Variable 10 - 20%	Principal and interest monthly

WHO DO I TALK TO?

When seeking a loan, you have several options depending on your financial needs and goals. You can approach big banks, which offer a wide range of loan products and typically have more flexible terms due to their vast resources, but they usually look for loan amounts exceeding \$100K. Local banks and community banks, on the other hand, might provide a more personalized experience, with loan officers who understand the specific needs of your area and may be more willing to work with small businesses or individuals with unique situations. Another valuable resource is Community Development Financial Institutions (CDFIs), which focus on providing financial services to underserved communities. CDFIs often offer more favorable terms and are more accessible to borrowers who might not qualify for traditional bank loans. Each option has its pros and cons, so it's important to consider your specific situation when deciding where to apply for a loan.

CDFIs

Community Development Financial Institutions (CDFIs) are specialized financial institutions that focus on providing financial services to underserved communities, particularly those that are low-income or economically distressed. CDFIs include banks, credit unions, loan funds, and venture capital funds, all of which aim to promote economic growth and development by offering affordable loans, credit, and other financial products. These institutions often work in areas where traditional banks may be less active, helping to support small businesses, affordable housing, and community development projects. CDFIs are certified by the U.S. Department of the Treasury and play a crucial role in fostering economic inclusivity and sustainability. Pasted below is a link to a website for the PA CDFI Network.

<https://pacdfinetwork.org/>

Big Banks

Big banks play a critical role in helping businesses of all sizes secure loans that fuel growth, expansion, and day-to-day operations. They offer a wide variety of loan products tailored to meet different business needs, including term loans, lines of credit, equipment financing, and commercial real estate loans. These loans provide businesses with the necessary capital to invest in new opportunities, manage cash flow, purchase equipment, or expand facilities. With their extensive resources and large balance sheets, big banks can offer competitive interest rates, flexible repayment terms, and significant loan amounts. They also provide specialized lending programs, such as SBA (Small Business Administration) loans, which are designed to support small businesses by offering lower down payments and longer repayment terms, often with government backing to reduce risk. Even though some small businesses may be able to obtain a loan from big banks, they are usually better for established businesses which look to loan amounts higher than \$100K.

Local Banks/Credit Unions

Local banks and credit unions are vital in helping businesses secure loans, especially within their communities. These financial institutions are often more attuned to the local economy and have a deeper understanding of the unique needs and challenges faced by local businesses. They typically offer a more personalized approach to lending, with loan officers who work closely with business owners to tailor financial solutions that meet their specific needs. Because of their community focus, local banks and credit unions may be more flexible in their lending criteria, making them an attractive option for small businesses or startups that may not qualify for loans from larger banks. Additionally, they often provide lower interest rates and fewer fees, along with the benefits of local decision-making and faster approval processes. This personalized service, combined with a strong commitment to community development, makes local banks and credit unions invaluable partners for businesses seeking the financial support needed to grow and succeed.

Community Banks

Community banks are essential partners for businesses seeking loans, offering a unique blend of local expertise, personalized service, and flexible lending options. Unlike larger banks, community banks are deeply rooted in the areas they serve, which allows them to understand the specific needs and challenges of local businesses. This local focus often translates into more tailored and accessible loan products, including lines of credit, term loans, and commercial real estate financing. Community banks tend to be more relationship-driven, meaning they often take the time to get to know their customers personally, which can lead to a more collaborative and supportive lending process. They are also typically more agile in their decision-making, allowing for quicker loan approvals and more customized terms. By working with community banks, businesses can benefit from competitive interest rates, lower fees, and the reassurance of dealing with a financial institution that prioritizes the well-being and growth of the local economy. These types of banks distribute more micro loans which are better inclined to lend to start ups.

Community banks serve a larger customer base compared to CDFIs without a specific focus in assisting low-income communities. Loan amounts usually total up to be around less than \$50K.

Lender Matrix

Type	Business Status	Loan Amount	Flexibility
CDFIs	Start up	<50K	Semi- Lenient
Big Banks	Well Established	>100K	Strict
Local Banks	Established 6 M -2 Y	50K – 100K	Semi-lenient
Community Banks	Established 1-2 years	<50K	Semi-lenient

BUSINESS LOAN APPLICATION CHECKLIST

Business Loan Application Checklist		
1	Loan application	Each lending institution has its own application.
2	Personal Financial Statement	Each lending institution has its own format.
3	Business Plan	Should include month-by-month financial projections for the next 12 months
4	Summary of Financial Needs	How much money do you need and what it is for.
5	Description of Collateral	that will be used to secure the loan. Usually can be both personal and business assets.
6	Business Tax Returns	Full returns with all schedules for the last three years. If purchasing an existing business, provide tax returns for that business.
7	Business Financial Statements	Year-to-Date balance sheet and income statement. They may be required for the last three years as well.
8	Personal Tax Returns	Full returns with all schedules for the last three years.
9	Resume	For owners and any key personnel responsible for business operations.
10	Agreement of Sale (if applicable)	Must be signed.

Different types of loans may require additional special documentation.

How Does the Process Work?

1. A conversation happens where you address your areas of interest and need so a financial institution can find a banker that is right for you.

Some questions a banker might ask you is:

- What is the purpose of the loan?
- Can you provide a detailed business plan?
- What is your business's current financial status?
- What are your revenues and expenses?
- Do you have any existing debt?
- What collateral can you offer?
- What is your credit history?
- What are your sales and profit margins?
- How will you repay the loan?
- Will your business be able to make the payment required under this loan?

If you don't have immediate answers to all these questions, that's okay. The lender will typically provide you a document outlining all of the requirements to apply. They may also give you a sense if a deal is possible with them. It's important to remember that your interests are aligned in this conversation, the rep at the bank gets paid fees to bring in qualified candidates, so if they can they want to get you funding.

2. In order for a loan package to be put together, be ready to display/explain the following:

- Business Plan
- Financial Projection (2-5 years month over month) - depending on size of the loan
- Tax Returns (personal/business)
- Previous Financial Docs (IS/BS) – depending on business status
- Personal guarantee

3. Send to underwriting

- Loan Officer hands off to person with decision authority on if you get approved
- Timing – Depending on size of loan can be anywhere from 1-3 days (for lessor amounts, to 1-2 months for larger amounts)

4. Approval/Denial

- The approval or denial phase of getting a loan is a critical step in the lending process, where the lender evaluates the borrower's application to determine whether they meet the necessary criteria for the loan. During this phase, the lender assesses various factors, including the borrower's credit score, income, employment history, debt-to-income ratio, and the purpose of the loan. They may also review the applicant's financial documents, such as bank statements and tax returns. If the borrower meets the lender's requirements, the loan is approved, and the terms are outlined. However, if the borrower falls short of the criteria, the loan may be denied, often accompanied by an explanation of the reasons for denial. This phase is crucial, as it determines whether the borrower can proceed with their financial plans or needs to explore other options.

5. Account Funding

- Account funding when getting a loan refers to the process where the approved loan amount is deposited into the borrower's designated account. After the loan is approved, the lender disburses the funds, which can be done through an electronic transfer directly into the borrower's bank account or by issuing a check. The speed of this process varies depending on the lender and the type of loan; some funds may be available within hours, while others may take a few days. Once the funds are deposited and cleared, the borrower can use the money for the specific purpose outlined in the loan agreement, such as purchasing a home, paying off debt, or covering other expenses. This phase is crucial, as it marks the completion of the loan process and the start of the repayment period.

| Aspiration |

Along with the accomplished Company team, and the high-impact leaders at the Department, we will set out to solve the greatest challenges facing small businesses in the region. We will catalyze change, not just cope with it. Our passion inspires entrepreneurs and our partners. Together we drive community impact.

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