BECOMING BANKABLE

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Becoming bankable

So you've come up with a good idea and started up a firm, only to find yourself confronted with a multitude of challenges with financing and growing your business? You're in good company: this is the first and fundamental issue many startups face.

I. Startup financing

To get the capital needed to start your business, you consider borrowing from a financial institution and visit a commercial bank. There you're faced with what seems to be an insurmountable obstacle: the bank manager tells you your firm needs to be formally incorporated for a minimum of 12 to 24 months to be eligible for a product offered by the bank.

Because of this requirement, startups generally choose to rely on their own funds or borrow from their owners, whilst the luckier – or more savvy ones – can also find ways to become crowdfunded.

Crowdfunding is an alternative option for raising funds. It is used to bridge the financing gap at the earliest stages of an idea or project and involves borrowing money from a large number of individual lenders, generally using online platforms. This has the added benefit of raising the visibility of your idea, product, or service in the community and creating the initial base of supporters and/or users. Promoting an idea in any field through a well-designed online campaign helps firms raise the initial funding they need. This finance can be extended by anyone, anywhere in the world, who may be interested in your idea for a wide variety of reasons and want to support it financially. This financing option is simpler because, unlike bank loans, it requires no guarantees and/or guarantors.

II. What's the first thing to know once you're bankable and ready to apply for a bank loan?

If you are bankable, and most businesses will be, you'll visit a bank and apply for a consumer or cash loan. That is what this article will mainly be devoted to – what happens once you've overcome your teething pains, managed to sustain your business for two years, and are, at least in theory, able to apply for a loan. Being aware of the application process, from entering a bank to choosing the right loan to having it approved, can save you a lot of time.

Once a prospective client has approached a bank, the staff there will collect information about it and review its performance and connected entities, assigning it a preliminary credit rating. This is how the bank assesses whether the client meets its lending requirements.

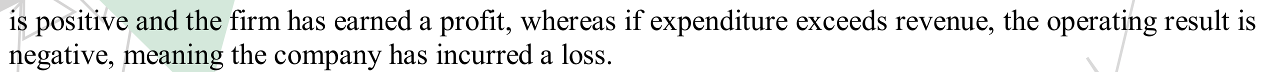
This preliminary assessment informs the bank's review of risk lists, sanctions lists, and sensitive activities, as well as other assessments of the prospective client's finances.

This stage is the first opportunity for the bank to decline to give the client an indicative offer.

Here, bankers will conduct a preliminary review of any documents provided by the prospective client against publicly available information. If the application does not meet the criteria for progressing to the next stage and potentially being approved – if there are legal issues or if it does not meet the bank's internal requirements – the bank will notify the client it is unable to provide an indicative offer.

Each commercial bank has its own specific set of requirements for documentation a client must supply if their application is to be considered. Below is a list of the key conditions that all banks look for and that clients should pay attention to, perhaps even before applying for a loan.

1. The client must have posted a positive operating result in the preceding two years. Operating result is an economic indicator of the financial results of a firm's operation and represents the difference between its total revenue and expenditure. If operating revenue exceeds operating expenditure, the operating result



is positive and the firm has earned a profit, whereas if expenditure exceeds revenue, the operating result is negative, meaning the company has incurred a loss.

2. The client is not in arrears. Being in arrears means being late in performing an obligation. The arrears banks are interested in concern late repayment of debts, so clients unable to pay what they owe to banks and other financial institutions on time will find themselves on banks' risk lists, and this poor rating will make it more difficult for them to borrow. Banks tend to watch out for clients who their assessments and analyses show will not be able to repay a loan they apply for. Not being in arrears also means the prospective borrower has not had its account frozen at any time. This information is available in records of enforced collections maintained by the National Bank of Serbia (NBS), as well as from the Credit Bureau. Banks look up Credit Bureau records for companies, their owners, and their connected entities.

2.1. The client and its connected entities must not have been subject to enforced collection or engaged in fraudulent practices, or had liabilities written off or bank accounts frozen. Connected entities undergo the same level of financial and asset control as the prospective client applying for a loan.

Credit history is crucial because banks use it to assess a prospective borrower's past behaviour. In doing so, banks check debts and business practices to arrive at what is called credit rating. Notably, poor credit rating due to debt does not lapse. Both positive and negative service-related information will show up in Credit Bureau reports for three years for physical persons and for five years for legal persons and sole traders, and this period starts from the moment the client's contract with the bank for a particular service ends. The data is automatically deleted on the final day of the month in which this period expires.

3. Watch lists. Warning signs that may affect a client's watch list rating include being in arrears, having a frozen bank account, liquidity issues, internal rating, deteriorating financial position, deteriorating market position, negative publicity in the media, delays in publishing annual statements, and the like.

Banks' watch lists will typically include high-risk borrowers. In practice, this means that, as early as it registers a client in its system, a bank will send out a warning that allows timely identification of borrowers whose elevated credit risk and exposures preclude lending to them. Before increasing credit exposure in any way, commercial banks will comprehensively and appropriately assess a client's creditworthiness against their internal criteria.

3.1. The Association of Serbian Banks' **Credit Bureau** provides added value to all players in the banking and financial markets. Credit Bureau reports allow compliant borrowers to capitalise on their timely performance to get better loan conditions, whilst banks and other service providers face lower lending risk and avoid burdening their balance sheets with non-performing and toxic liabilities.

Credit Bureau reports show all services used by a client. These data can be either positive or negative. Positive information comprise any services used (such as loan amount, repayment period, and the like), whereas negative information show payment arrears.

4. The client must not be on a fraud list or blacklist. Banks have latitude in assessing risks lending to any client will entail, and, to facilitate this assessment, they produce fraud lists or blacklists.

A key reason why banks perform these assessments is to check whether a prospective client has been involved in suspicious activities and/or transactions (these are crimes such as forgery, misrepresentation, money laundering and the like).

To strengthen these controls and prevent any abuse, banks communicate with one another and exchange information. The NBS also engages in special controls that banks can rely on for more precise information. Fraudulent practices are also monitored by the Ministry of Finance's Financial Intelligence Unit: any transaction of more than 15,000 euros is automatically reported for audit to this body, which investigates money laundering and financing of terrorism.

5. The client must not have posted losses above equity in the preceding two years. A firm's equity is the difference between the value of its assets and the value of its liabilities. If this difference is negative,

the company has incurred a loss above equity. Businesses often cover these losses using their own funds, including by selling their capital (property, equipment, land, buildings, and the like). This does have the benefit of making up for the loss, but nevertheless reduces a company's capital. The key consequence of posting losses above equity is that the company resorts to financing its assets by borrowing. In fact, the company owns no assets and has no equity that constitutes the difference between its assets and its liabilities. The totality of its financing comes from borrowing. These companies consistently incur expenditures in excess of their revenues, which then leads to accumulating losses and, in all likelihood, drives the company into liquidation.

To get reliable data on a prospective client's performance, when approving their products banks track whether the client's owners have lent money to their company, and, if so, how frequent this practice has been. Banks also seek to learn whether the firm has actually turned a profit or if it has been concealing losses and covering up the fact it lacks funding to meet current expenditures and day-to-day operations. Banks will also look at buyer and supplier records to understand the relationship between future income and outstanding expenditures, including how much a prospective borrower owes, how many buyers it has, which of those buyers are regular customers, whether one particular buyer accounts for the majority of the firm's revenue and how much it owes the company, whether the prospective client is dependent on one or multiple buyers and what their relationships are, and so on. This effort allows a bank to gain a broad picture of a possible client's operations and its dependence on any buyers, helping it to assess whether bankruptcy or default by those buyers could make the prospective borrower insolvent and prevent it from making timely payments to the bank.

III. Three categories of lending: overdrafts, business cards, and loans

Overdrafts. To quickly bridge liquidity gaps (in meeting recurrent monthly liabilities), overdrafts are the recommended product if the financing is likely to be required for only several days in any given month. Due to their cost, overdrafts are not advised if this facility is to be used throughout the month.

Business cards. These payment cards are used for corporate entertainment expenses and offer additional benefits. Banks can supplement them by offering travel insurance cards, which can also be used to pay for accommodation and services during official travel, which makes them more cost-effective to the client than short-term loans and also provide a range of options to save by eliminating other expenses.

Working capital loans – used to finance purchases of raw materials, finished goods, and inventory

Depending on the client's industry and type of business – in other words, what type of working capital the client needs to finance – banks offer both short-term and long-term working capital loans.

Long-term working capital lending is suited to clients that prefer to focus less on current liabilities than on financing long-term company requirements and long-term business, as well as that need more room to accumulate disposable capital. Depending on the amount involved, bills of exchange and guarantees are the most commonly required types of collateral. 'Hard' collateral includes senior or junior mortgages and liens on equipment, goods (with a value and economic service life acceptable to the bank), and accounts receivable (liens on contracts or invoices with creditors deemed acceptable by the bank).

Short-term working capital loans are geared towards meeting current needs and permit business and profit growth while making cash flows and liquidity more stable.

Revolving loans. These allow borrowers to match cash inflows and outflows arising from current operations and finance periodic working capital needs. In this type of lending, the borrower agrees a repayment period with the bank and is able to make payments on its own schedule provided it does not exceed this period. These loans must be secured by the borrower's bills of exchange and the owner's personal bills of exchange, whilst optional forms of collateral include mortgages, liens on movable items, guarantees, warranties, deposits, and the like.

Multipurpose framework credit lines. In this facility the bank approves a credit ceiling to the borrower. The key benefit of this type of lending is that it removes the need for lengthy, demanding loan approval processes whenever a loan is needed. This is a universal solution for all companies in that it combines several different financial products. These lines may be short-term or long-term, depending on the borrower's needs. Its advantages include one-off approval, flexibility in using the proceeds, ability to use to proceeds for a variety of purposes, and the like. Framework credit lines can be utilised to extend loans, guarantees, and letters of credit. Hard collateral is needed to secure these facilities.

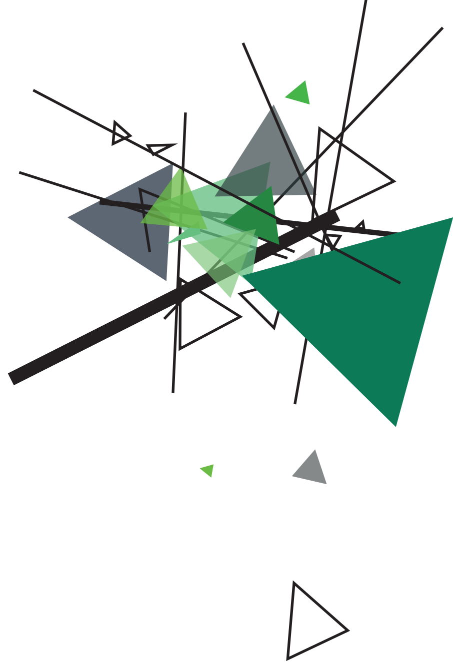
Investment loans. Long-term investment lending is aimed at clients wishing to finance equipment, refurbish, build, or purchase office space, and refinance their long-term liabilities under more favourable terms. The borrower's deposit (or down payment) required for these loans depends on their purpose and feasibility, with banks being flexible over grace periods. These loans are secured by the borrower's bills of exchange and the owner's personal bills of exchange, whilst optional forms of collateral include liens on movable items, mortgages, guarantees, deposits, and the like.

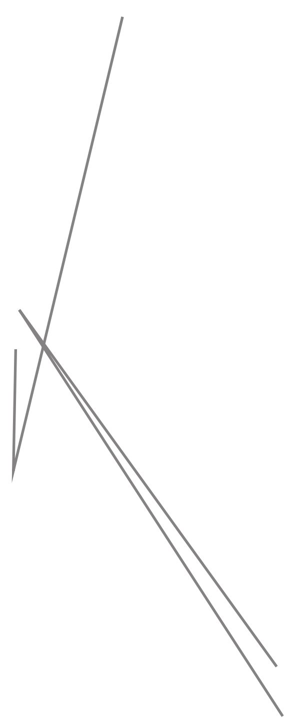
Lombard loans are loans wholly covered by deposits with the lending bank. These have no formally identified purpose and may be used by the borrower to meet any needs. A Lombard loan can only be denominated in Serbian dinars, whilst the deposit used to secure it must be in euros. For instance, the borrower must have foreign currency in an account with the bank, which serves as collateral for the loan – no deposit means the borrower is not eligible for a loan of this type. If a Lombard loan is approved, the deposit will be frozen in a special-purpose account and no lien will be registered with the Serbian Business Registers Agency. Lombard loans are secured by borrowers' deposits and bills of exchange.

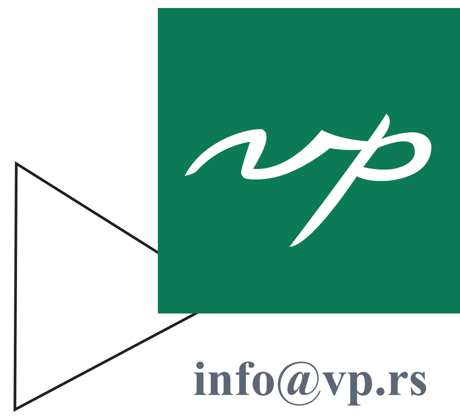
IV. Doing business safely and minimising risk

Any new company must be sure to make the right and safe business moves, especially in its early years of growth. When considering and applying for a bank product, the first step is to seek professional advice about the challenges your business faces and how you can overcome issues you may not be wholly familiar with.

Banks adjust their operations to reflect global and local conditions, the state of markets, and topical issues. This means banks tend to offer special conditions and benefits particularly suited to the emerging needs of groups of current and/or potential clients. Once you have become eligible for a loan, you should consult a good accountant about how to track and monitor your performance so that your accounting reflects reliable operations free of major risks. Lastly, you should find an experienced banker to help you choose the right loan for your business and minimise costs. Doing business responsibly and safely early in your company's life is the foundation and key to the firm's future success and growth.







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