

The 5 Cs to Consider When Applying for a Business Loan

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For some entrepreneurs, bootstrapping your business isn't an option. That's where finding an alternative method for obtaining capital comes in. Business credit is the most well-known option for an entrepreneur to receive an influx of capital.

Business credit is the ability of a company to borrow money to buy something now and pay the money back later. When a business goes for credit, there are five things (the five Cs) that a lender will look at before approving the company for a loan. Here they are below:

1. Character

Character refers to your business' credit history. Depending on the history of your business, your personal credit history may also come into play. If the character review of the borrower shows a history of responsibility for paying back lenders and credit maturity via prior credit lending opportunities (e.g., credit cards, lines of credit, auto loans), the borrower is likely to be approved for the loan. If the character of the borrower displays an immature credit profile (e.g., no prior credit lending, delinquencies, collections), the lender is likely to reject the borrower.

Similar to personal credit, there are ways you can check your business credit profile, such as Nav.com and DNB.com (Dun and Bradstreet). Business credit profiles are not as mature as

personal credit, so you may see discrepancies in your various reporting source profiles.

Related: [5 Tips for Securing the Business Credit You Need to Start and Scale Your Business](#)

2. Capacity

The capacity of a business is the ability to pay back a loan. A lender will look at your debt-to-income (DTI) ratio to calculate capacity. The formula to calculate your debt-to-income ratio is $(\text{total debt} / \text{total income}) \times 100$.

The lower your DTI, the better your capacity to pay back a loan in the eyes of a lender. As with personal credit, you want to keep your business DTI at 36% or lower to be considered for future lending opportunities.

3. Capital

Capital is your business's assets the borrower can leverage to repay a loan. Only liquid assets – such as bank account funds, investments and assets the lender can claim – are considered. Accounts receivable are not capital in this case, because it is not tangible.

Related: [How to Qualify for a Business Startup Loan](#)

4. Collateral

Collateral is an asset that can be offered as security to reduce the risk of capital loss in the case of default for the lender. Examples of collateral would be property, cash, inventory, accounts receivable or equipment.

As a general rule, lenders will loan 80% of the value of the collateral. This means the borrower would need to have 20% of the purchase amount on hand or an alternate means to raise the

capital. This is known as a loan-to-value ratio.

5. Conditions

Conditions include how the business plans to use the money and external factors, such as the state of the economy. For example, an equipment loan may be less risky for a dropshipping company than a loan for working capital in a risky business environment, such as a lending firm.

When applying for credit, some of the five Cs are more in the business's control than others. Let's discuss how to increase your chances of being approved for credit by improving character, capacity, capital, collateral and conditions.

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How to increase your chances of being approved for credit

- **Improving character:** Character is absolutely on the business to maintain. Some ways to improve your character rating include paying bills early or on time that are reported to credit bureaus (e.g., credit cards and lines of credit), having a higher age of credit, diversifying your credit portfolio with a mix of revolving and installment credit and getting adverse events (like late payments) removed or closed. By calling the number provided, you can verify that your credit lenders report to the credit bureaus. Some lenders, primarily net 30-90 vendors, may not report until you request it.
- **Improving capacity:** The business needs to make more money or incur fewer expenses to improve capacity. Another option is to have a cosigner with a low DTI to

improve your DTI.

- **Improving capital:** Capital is tougher to control by the business if the business is struggling to generate revenue. It is recommended that the business begins to save as much as possible in preparing a credit request to ensure the debt-to-income ratio will be 36% or lower. Some lenders will lend credit at a higher interest rate, up to 50% DTI.
- **Improving collateral:** Collateral is harder to control for businesses, primarily digital businesses, because the collateral, in most cases, must be liquid and owned outright. One way to improve the strength of collateral is by entering into a secured loan agreement leveraging additional assets that are equal to or higher than the loan amount.
- **Improving conditions:** Conditions are typically outside of the lender and borrower's control. The borrower must have a solid reason to request the loan and a strong enough credit profile to fit the lender's lending criteria. It helps the business to have financial documents in order and a strong outlook on revenue generation.

There are a lot of considerations when requesting a business loan. Establishing relationships with lenders helps to strengthen the chances of being approved for a loan. Still, the most important attributes to consider are DTI, the reason for the loan and the business outlook. You should consult your financial advisor or accountant before pursuing a loan.

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