

# Managing Business Debt

By Tom Wilkowske

## What, When, Why, Where—and How.

**W**ith all the gloomy economic news floating around these days, it might seem tempting to reach for some easy credit to get your business through rocky times.

No question, it sure looks easy.

Those impossibly low interest rates seem to be just one Google ad click away. Those teaser rate credit card offers sing their siren song from your mailbox (and, you're saying to yourself, you promise you'll switch to another card before the teaser rate expires).

Be careful, say local business and finance experts.

If your balance sheet looks good but you're just nervous about the future, you could wind up smudging your credit record. If you're in debt now, you could wind up digging a deeper hole. And you might be masking problems with your business practices that, if fixed, could get the cash flowing again, without the need for debt.

### DEBT CAN BE YOUR FRIEND

Still, taking on more debt now can be the right thing to do for some businesses, despite the blaring headlines about the credit crisis and the crash of such high-flying Wall Street bankers as Bear Stearns, which was sunk by trading in risky sub-prime mortgages.

"From our point of view, we never went to the party so we never got the hangover," said Dale Lewis, president of Park State Bank, which has offices in

Morgan Park, Lincoln Park and Minneapolis' Warehouse District. "We make good loans. It shouldn't affect good loans for good borrowers." However, it's imperative to keep an eye on the financials. "The cash flow needs to be monitored very carefully at all times," she said. "It doesn't mean debt is bad or evil. It just needs to be monitored."

Tim Meininger is president of Beacon Bank's Duluth office. At his bank, which is primarily a business lender, "Debt requests are at an all-time high."

But who should borrow, and when?

"The time to borrow money is when you know you can make a return on it," he said. Maybe debt could create an advantage for you to sell more product.

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—Tim Meininger, Beacon Bank

This could be an opportune time for some small businesses, according to Elaine Hansen, director of UMD's Center for Economic Development, which offers education, training and some free consulting services to businesses and employees.

But she has some caveats.

"If you truly need credit, if you're looking at an expansion, and you know you have the market and the sales, it might be a good time to expand," said Hansen, a certified public accountant who has a background in government agency management.

Or it could help you produce your product more efficiently. However, "If there's no return there, now would not be a good time," he adds.

Jim Denney, a certified public accountant and assurance partner with RSM McGladrey Inc. in Duluth, echoes the caution.

"As long as the rate of return is greater than what you're paying on the debt, it's usually a win for the [business] owner," Denney said. "However, if your cash flow declines, then you're at risk." That's why Denney recommends against borrowing



Before  
you choose  
the one  
you want –



How many shoes  
do you try on?



How many cars  
do you test drive?



How many houses  
do you tour?

to the hilt. "You have to know what your capacity is to repay it," he said. "Know your cash flow, know your principal and interest, and you want to leave a good margin to allow for changes in business performance."

Denney said a business owner considering taking on debt should know what's typical for his or her industry and stay within that range. Whereas a mature manufacturer might be only moderately leveraged, at a 1-to-1 debt-to-equity ratio, a startup might have a 3-to-1 ratio, where the lender holds 75 cents of debt to every 25 cents of business equity, he says.

#### CHARACTER AND CREDIT

Lewis said Park State Bank has shown good loan growth in each of the past 10 years, except for last year. "We're down a percentage," she said. "Businesses are maybe a little more cautious with expansion or increasing inventory or trying a new [product] line."

The industry struggling now is new housing development, Lewis said. "If somebody wants to buy 160 acres, divide it into lots, and put in roads and sewers, that's going to be a real tough deal to get done, probably in all markets, unless that borrower is extremely well-heeled, is highly experienced and has staying power."

Regardless of the reason you need credit, it's best to establish a good working relationship with a local bank, Lewis said.

"Any small business should have a banking relationship, even if they're not borrowing right now," Lewis said. "Get to know your banker, share financials with them, share successes so that when there does come a crisis or a time of need, then they're familiar with you. They've got your statements on file and can just move forward from there."

When looking for a lender, a business needs to look at the rate offered, but it's probably not the most important factor. That would be a good working relationship. "I hate to say 'personality,' but a lot of it depends on trust," Lewis said. Bankers size up a would-be borrower according to what's called the Five C's of Credit: Character, Conditions, Capital, Collateral and Cash Flow. "Character is a biggie and if we've already gotten over that hump, you're already on the way to getting the credit you need," she said.

Another advantage of smaller local financial institutions: Many, like Park State Bank, service most of their own mortgages, rather than originating them and reselling on the secondary market.

## DEBT DO'S AND DON'TS

- **Do** forge a continuing relationship with an area banker. Find someone you can work with and establish a good track record so there's a foundation if you wind up in a debt squeeze.
- **Do** update your business plan and financial statement. A months-old financial statement isn't useful when shopping for loans. A good business plan makes a good impression on banks.
- **Do** use appropriate collateral for the appropriate borrowing – for example, use receivables as collateral for purchasing inventory.
- **Do** consult business counselors at UMD's Center for Economic Development ([www.umdced.com](http://www.umdced.com)) for advice and assistance on building business plans and sorting out cash flow issues.
- **Don't** borrow to get through a short-term cash crunch. Dig into what's causing the problem; it may be business practices.
- **Don't** take on a large amount of debt (as in a major expansion or business acquisition) without consulting with your trusted advisers, including a banker, lawyer and accountant.
- **Don't** use short-term debt, like credit cards or revolving credit, to purchase long-term assets like equipment (vehicles, for example).
- **Don't** borrow to the maximum of your cash flow; allow a cushion in case business softens.
- **Don't** shop rates alone when looking for lenders. Consider other factors such as flexibility and personal service.

That fact can make it easier to negotiate relaxed terms when a business is suffering a cash crunch.

Hansen feels that keeping in touch with a banker can pay other dividends. Bankers know about new, alternate sources of small business funding. One example: the Small Business Administration's Patriot Express Pilot Loan Program ([www.sba.gov/patriotexpress](http://www.sba.gov/patriotexpress)), intended for veterans, active duty military personnel, National Guard and reserve members, veterans and their spouses.

#### MAYBE YOU DON'T NEED IT

Then again, maybe your business doesn't need another loan. Maybe tuning up some of your business practices could get the cash flowing in a more positive direction.

Here's an idea: Instead of borrowing against receivables, collect them.

"One of the most common problems we see is failure to collect on receivables," Lewis said, "maybe due to fear of confronting your customer. But if they're not paying you now, you don't want them in the future."

Hansen of UMD's Center for Economic Development concurs on the need to speed up collection of receivables. "In a time like this, businesses that sell a lot on credit, people aren't paying them either," she said. Be assertive. Call and send second and third notices. "It's surprising how many people don't send monthly statements," she said.

Business counselors at the economic development center ([www.umdced.com](http://www.umdced.com)) also see another common mistake: ordering too much inventory. "Maybe some of these folks should be buying smaller quantities so they aren't hit with such big bills," she said.

Hansen said the center's Small Business Development Center offers free counseling to business owners, who may simply want to get some ideas or may be in a bind with debt.

"We've had several business owners come in having cash flow and financial difficulties, and by looking at where they're spending, how they're collecting and how they're ordering, we were able to help them out and right now they're in fine shape," she said. **D**

Tom Wilkowske is a freelance writer based in Duluth.

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