# Economic Realities: You and Your Banker

Robert Petlz, Vice President and Bank Manager
Crocker National Bank
San Francisco, California

After listening to some of your comments, I should change my title from "What your banker expects and needs to know" to "How I expect to get paid after I lend money to Audiologists." Before I start, I expect to be here for another day or so if you have any further questions I'll be available.

After listening to the talks this morning, I would like to comment on an IBM executive talking to new members of his sales force as he asked them the question "What does IBM make?" The answers were hardware, software, and typewriters. Of course they were all wrong. IBM makes money, as does George Haspiel, Crocker Bank, and hopefully all of you. It is this concept of making money that we all ought to be thinking of. I would like to take exception to the problems that you think you have as audiologists as it pertains to money. Believe me, your problems are no different from most of my business customers, and you should all be thinking positively about how are you going to make money.—Remember there is competition in every field of endeavor. With that, I would like to proceed.

The only item I want to read today, and it will be very short, pertains to the Equal Credit Opportunity Act (ECOA) and Regulation B of the Federal Reserve Board as passed in 1975. These regulations gave women the opportunity to go to a bank and borrow money on their own credit instead of being tied to their spouses. Their opportunity to borrow money to go into business and/or purchase a home was now greatly enhanced.

"ECOA and Regulation B prohibited discrimination on a prohibitive basis in any aspect of a credit transaction. More specifically, a creditor cannot discriminate as to race, color, religion, national origin, sex, marital status, age, or receiving of income from public assistance programs in good faith as exercised under the rights of the consumer credit protection act."

In this respect, ECOA and Regulation B applies to business and personal loans. In essence, any one who is qualified can not apply for a loan and be granted the same with all things being equal. In the State of California due to the community property laws, a wife can request a loan to go into business, etc., and use her half of the balance sheet assets, i.e.: real property, personal property, cash, stocks, etc., without the husband's consent or knowledge. Other laws prevail in other states; however, the concept is the same: the ability of anyone to apply for credit and if deserving to obtain same.

As a banker, what do I have to know from you when you come in to see me to request $20,000 to go into private practice as an Audiologist? What you should have been thinking about is how much do you need; for what; and how are you going to repay. Three very basic items! Some borrowers still think that they have to repay business loans in 90 days. The purist example of a short term loan is the toy shop owner who borrows funds in August to purchase toys to sell at Christmas and repays the loan in January. However, an audiologist going into business or purchasing new equipment for his business must be thinking of repaying in three to seven years out of income or cash flow. This is one of the basic functions of the banker in advising you as to the length of the repayment schedule.

In addition, you should itemize on a piece of paper each item that you are going to purchase for the office: i.e.: booth, audiometer, furnishings, etc. with purchase order estimates for each of these. You should include everything possible as it is easier to pay back so much per month than to have to pay full cash for items not being financed.

Now, what do I need from you to see if you're worth lending money to. The items we would be looking at are: 1) Personal Financial Statement; 2) Two to three years of Internal Revenue returns; 3) Biographical sketch; 4) Credit; and 5) Pro-forma.

The personal financial statement tells the banker about your assets and liabilities and financial strength as of a current date. It tells him how you have increased your net worth over a period of time; what you have accomplished over the past five to seven years of work experience as compared to a previous personal financial statement.

The pro-forma asks where are you going to be over the next year or two. The pro-forma asks how much is it going to cost to open the door each month including the loan payment. Now we include living expenses and therefore we are able to determine how much business you are going to have to produce to pay the above. As bankers, we know that few businesses are in the black right away. However the pro-forma will show us when you are in the black or do have a positive cash flow based on your estimated income. Therefore if we do extend to you a three to five year loan then we can defer the monthly payments by three to six months or until your cash flow is in a positive mode without causing any hardship. Remember, the bank is going to want its loan repaid as soon as possible, and you should feel the same way about your outstanding receivables. Remember, it is not against the law to ask for the funds due you!

If you are going into the market place to borrow for the first time, it is a good idea to give your banker a biographical sketch. Your bank might know some things about you as per your commercial account or maybe that you have a savings account. However, what about your credentials, your work experience, your education, your publications, etc. anything that looks impressive. Remember, you are requesting money to go into business, normally for the first time, so anything you can give to the banker to make him and the bank feel more comfortable is worthwhile.

It goes without saying that without good credit the bank will not lend money. Even for those potential borrowers who do have good earnings, if their credit is poor they will probably not be able to borrow. It stands to reason that if someone does not pay his past bills why should he pay his present or future obligations. Remember, all personal loans, i.e. for automobiles, department store charges, Master Charge, Visa, are all reported to the local credit bureaus. Therefore, you must assume that when you request money from the banker he is going to run a credit check on you.

Let me now discuss the three or four different ways that you, the potential borrower, can expect to borrow funds from the bank to pay for your initial start up in business.

**Savings:** If you have a savings account you can of course take out the funds and pay cash for all your equipment therefore bypassing monthly payments and interest expense. You may, if you desire, borrow against your savings dollar for dollar paying an interest rate of 2% over what you are receiving on your savings account. The advantages of this type of borrowing is that it is cheaper, it's secured, and it does not have a forced or formal repayment program. All the bank requests is its monthly interest, but you must keep in mind that you have locked up your savings and cannot use this until the loan is reduced or paid off.

**Stock Secured:** Potential borrowers who do have listed stock might want to borrow against their stock instead of selling it. The bank will lend you 65% of the market value of the stock, holding the certificates for security. With this loan the interest is higher—about three to four percent over the prime rate, with monthly interest being paid. However, the benefit here, as in savings secured loans, is that there is no set monthly reduction payment, thereby offering you, the new audiologist in business, the opportunity to save your cash flow for running the business. One of the detrements to this type of borrowing as in savings secured or against cash value life insurance is that there are no demands upon you to repay the principal, and before you realize it the loan has been out for three or four years, you have been paying interest only and still owe $20,000 principal. We call these evergreen loans.

**Term Loans:** Normally most new borrowers would probably request a term loan of three to seven years to purchase needed equipment with a set monthly repayment and a full payout at maturity. In this type of loan the interest would probably fluctuate with prime: say three to four percent over. However, your monthly payments would be constant. The benefit here is that you lower your monthly cash drain by extending the term of the loan. Normally these are written at simple interest and therefore you can repay quicker without any form of prepayment penalty. It is here again that the banker can help you by deferring your monthly repayment for three to six months or until your cash flow is adequate to handle all your payments.

**Home Equity or Second Deeds of Trust:** In California, with the great appreciation in real estate home values the banks have been making fifteen year equity loans secured by a second deed of trust on your home. The maximum is 80% of appraised home value, less the balance of the first mortgage with a constant monthly repayment to amortize the total loan in fifteen years. The normal interest rate is betwen 12-13%, actual percentage rate.

In all of the above the blunt fact is if you have the need or opportunity to go into business and if you must do it then you have to borrow on your own resources on terms which are both beneficial to you and your banker.

Let me comment on receivables before we proceed to the questions and answer period. All businesses must have some receivables, but the less you have the better off you are. The more patients that you can get to pay cash or put on Master Charge or VISA and pay the discount to the bank is much better than on the balance sheet as receivables, due and not collectible. As a business person you must turn those receivables into cash as quickly and as cheaply as possible, otherwise you have collection problems, losses, and expenses of borrowing from the bank to pay payables and stay in business.