

Determine if a Loan Can Help Your Business Succeed

Whatever a loan enables should improve your business and increase your profits.

A loan might help you increase productivity, lower your costs, or grow your sales. If it doesn't do one of those things, then debt likely isn't the answer — at least not right now.

For example, if you're thinking of using a loan to bail yourself out of a difficult situation, that's a red flag. As is not having a clear sense of how a loan will enable your business to succeed.

Do you have a simple and persuasive explanation for how a loan will improve your business?

- Yes. Congratulations! This is an all-important step in getting ready to apply for a loan.
- No. We recommend you don't apply for a loan right now and instead work on your business plan and determine how a loan fits into that plan.

How much can you afford to borrow?

The industry standard measure of this is your debt-service coverage ratio (DSCR). You can calculate your DSCR by dividing your cash flow (the net profit, plus any interest, depreciation, or amortization expenses) by your debt payments.

Your DSCR can tell you how much debt your business can afford.

Let's say you need a \$15,000 automatic pasta machine to really take your lasagna business to the next level. A quick DSCR calculation, however, shows you can only afford a \$10,000 loan.

In this case, presuming you have no way to cover the \$5,000 shortfall, taking out a loan that only covers 2/3rds of the project cost is likely a bad idea.

Banks and credit unions will typically look at previous performance to see if that history will let you service the debt you're considering taking on. They often require a DSCR of 1.25 or greater.

At Craft3, we look at historic DSCR, but we also consider projections if your historic DSCR isn't high enough to support the loan.

While we want to connect you with capital, we never want you to take out a loan that isn't likely to help you succeed. Before applying for a loan, make sure you understand how a loan will drive the success of your business and that you seek to borrow only what you can afford. A responsible lender should be able to help you think through both of those.

CALCULATE YOUR DSCR

Cash flow

Total debt payments

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