Credit strategies and needs for later-stage businesses
Making the most of your approach to business credit

It’s rarely a question of if a business will need business credit, but when. From bridging the gap between busy seasons to investing in that second location to help drive business growth, financing can be integral to meeting a variety of business needs.

But financing can look different for established businesses. As businesses become more seasoned, they’re more likely to be able to make use of products designed to meet their specific business needs, and to leverage the expertise of internal and external resources for help identifying these products’ appropriate uses.

In this guide, we’ll explore these different credit options, how they may be a key factor in helping your business meet its goals, and the ongoing importance of prioritizing responsible credit use.

Take steps to help ensure the long-term financial health of your business. Leverage the information in this guide and reach out to your Wells Fargo Small Business Banker when you’re ready to explore your options.
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Review business needs before you apply for credit

Learn some of the steps you can take to help ensure your business assets are optimized before you apply.

Like many aspects of running a business, the process of applying for credit can evolve as your company does. When you needed start-up financing, personal savings or personal credit might have been the most readily available options. Now that you’re able to prove the sustainability of your business, you may want to consider obtaining credit that better supports the particular needs of your business or industry.

It’s essential to ensure you’re undertaking this process in a way that may help set your business up for long-term success and maintain its wellbeing as you pursue new credit avenues.

First, match the right credit product with your business needs
To prove creditworthiness, begin by demonstrating you are able to identify appropriate products for your needs.

“It is key that you’re matching the term and the structure of the credit to the type of need that you have,” says Carmen Brun, senior vice president of small business term lending at Wells Fargo. “For example, if you buy a piece of equipment, and it lasts 10 years, you don’t want to still be owing money on it in year 11.”

Similarly, securing a loan with collateral that may not endure the length of your repayment period probably isn’t the most suitable credit option.

Consider in general terms:
- **Credit cards** are better suited to helping to establish credit for a business and increasing day-to-day purchasing power.
- **Lines of credit** are better for supplementing cash flow and covering unexpected expenses.
- **Loans** are better for bigger, planned purchases, such as equipment and paying off debt over time with lower interest rates.

Next, evaluate the complexity of your credit needs
In some situations, a business owner’s credit needs may be considered complex. For example, the ownership structure of the business can often complicate the situation – such as when there are multiple individual owners, or some or all of the ownership is held in a trust or by other corporations.

If your business requires multiple credit products, the documentation often will be more complicated when the bank cross-collateralizes and cross-defaults all of the credit, says Mike Strathman, senior vice president and division lending manager at Wells Fargo. In more complex situations, the bank may enlist legal assistance to prepare the actual loan agreement.
“Since a more seasoned business has built more capital, it gets back to, ‘What is the business trying to do?’” notes Brun. “The complexity and dollar amount of the credit may become more of a driver [around your approval].”

Consult with your financial partners
Work with your key financial stakeholders and any outside subject matter experts to confirm you’re looking into the type of credit that will provide the greatest value to your business efforts within a reasonable amount of time. Go over what to expect during the application process to help prepare required documentation in advance.

Strathman recommends starting with your banker to discuss the purpose driving the business credit needs and what possible products and solutions meet those needs. Your banker also can explain what type of financial information will be needed to help you make a more informed decision.

Then, talk to your CPA to help verify your business has the capacity to repay the debt. Ensure the new credit will not create an unhealthy amount of leverage on your balance sheet. Your accountant may help ensure all financial information is accurate and up to date to meet the bank’s requirements in order to make a credit decision.

To ensure you’re taking on debt pragmatically, refer to the current ratio formula (Current Ratio = Current Assets / Current Liabilities). Businesses should typically aim for a current ratio above 1.0, which means liabilities do not exceed assets.

Then, re-evaluate budgets
As more accurate assessments of valuations are developed, re-evaluate your budgets accordingly. Consider how your accounts payable reflect business priorities, which may have shifted since you last acquired a major client, completed a fiscal year, or made a structural change to operations.

If you’ve been overvaluing certain items, strategic cost management may help you reassess your business expenses. Conversely, learning you possess more capital than you previously thought could provide you more funds to invest back into the business. Demonstrating that you’re allocating funds strategically, with the goal of contributing to the priorities you sought credit for, may be another way to show lenders you’re serious about these efforts.

Brun recommends asking: Will financing close a short-term gap in cash flow or cover larger expenses? Will that purchase help you generate value above and beyond the cost of financing? Planning for the impact of financing on your business may help you decide how much, if any, financing to pursue.

This process may help you determine whether to pursue a new credit option or sit tight with newfound resources and options.

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Manage multiple credit types for different needs

Get to know how different types of credit may keep you on track with all of your financial goals.

Businesses that have developed and proven their sustainability are typically no longer asking whether they can obtain financing: they’re looking at which types of credit make the most sense for their unique circumstances.

At this point, business leaders may find they’re able to support different needs by leveraging multiple credit products at once. But identifying the appropriate mix is crucial.

If you’re paying extra for funding, it will have a ripple effect, says Jim Olp, senior business consultant for the Denver Metro Small Business Development Center. “You may have to cut your own salary, or lay off an employee.”

Don’t just mix credit products — match them
The main reason leaders seek to mix multiple types of loans is known as maturity matching, which entails complementing short-term needs with credit products like a line of credit or credit card, and long-term needs with products such as commercial equipment or real estate loans.

Consider the implications of using certain products for particular business efforts. For instance, Steve Milani, vice president, business cards and lines manager at Wells Fargo, points out, “You don’t want to use a revolving line of credit to buy a vehicle, because a revolving line of credit is designed for balances that the user expects to pay off relatively quickly, which may not be realistic in the case of a vehicle purchase, and the vehicle then goes down in value. That’s not a good match.”

Consider how you may fold these types of short- and long-term credit products together into a cost-effective financing strategy.
**Short-term options**

**Line of credit:** Used to navigate temporary budget crunches or spending surges. It’s not designed to shoulder long-term debts. It also provides assurance of a source for immediate funds, if needed.

**Asset-based lending:** Ideal for businesses that need a sizable influx of cash but expect to be able to recoup it quickly. For example, floor-planning is one type of asset-based loan, which enables retailers to stock showrooms before a holiday sales surge. There’s also factoring, which lets businesses borrow against their accounts receivable.

Asset-based loans can be a good option, Olp says, because they don’t depend on traditional collateral: floor-planning uses the merchandise as collateral; factoring uses the reliability of a business’s clients as the deciding issue.

**Long-term options**

**Commercial equipment financing:** Can help fund specific purchases such as construction equipment, commercial vehicles, or other large, depreciable capital assets. These loans will typically accept the asset being purchased as collateral to help lower the overall cost of borrowing.

**Term loan:** Useful in providing financing to businesses as they manage expenses associated with growth, such as adding employees or opening a new office. They generally have a fixed rate and set amortization schedule to provide transparency into the total cost of financing so you will know when the debt will be paid in full. SBA term loans are ideal for growth, including commercial real estate purchases, expansion, or partner buyout.

**Specialty financing**

Specialty financing is typically defined as lending done outside of a traditional financial institution. Given that environment, these types of lenders may take a different approach to assessing whether a business is a viable financing candidate. Because this form of lending may not focus on the same criteria as a bank would, there may be more flexibility in negotiating terms and pricing.

To carefully manage these products simultaneously without overextending them, business leaders should work with multiple internal stakeholders to review sales forecasts, business priorities, and external factors such as real estate, inventory costs, and the economic climate of their industry.

By leveraging a smart, tailored combination of financing products that help support specific goals, businesses can potentially position themselves for growth.

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Using credit to weather disruption

Five ways to financially prepare your business for a disaster.

Whether it’s a natural disaster, a delay in the supply chain, or a major IT systems failure, disruption can affect any business. To prepare for the unexpected, it’s critical that businesses have a plan in place to weather any interruption.

Having access to credit can be a major asset when emergency strikes. Steve Milani, vice president, business cards and lines manager at Wells Fargo, offers advice for business owners on how they may leverage different credit tools to keep their core operations up and running in the wake of disruption.

1. Apply for a line of credit before you need it

Milani suggests applying for a line of credit before a disruption occurs. “When bad times hit, it can be much more difficult to obtain credit,” Milani says.

“Obtaining a line of credit and holding onto it is a great way to prepare your business for any future disruptions,” he says. “A line of credit can hopefully cover several months of business cash flow needs if your business is interrupted for a significant period of time.”
2 Set aside an emergency credit card
Designate a credit card to set aside for emergencies, preferably one with a generous credit limit, Milani recommends.

He suggests looking for a business credit card you can pay back in several weeks’ time. Also, utilize lower-interest credit tools, such as lines of credit for businesses that need access to financing for longer periods of time.

Credit cards may be helpful for post-disaster record keeping, too. “You’ll have itemized purchases conveniently listed that you can reference if you need to make any insurance claims,” Milani says.

3 Take advantage of available lending options
The SBA offers two types of low-interest loans for businesses that have been affected by disaster:
• Physical disaster loans, which may be used to help replace or restore damaged property.
• Economic disaster loans, which may be used to help your business survive until normal operations resume.

After a disaster, applying for these loans as soon as possible may help you beat the backlog of businesses that will also apply. To qualify, your business must be in an affected area as stated by a disaster declaration.

Further, some private financial institutions offer financing or waive payments for businesses affected by disruption. “Wells Fargo will help out business owners after natural disasters by freezing payments due and suspending late fees on credit accounts,” Milani says.

4 Keep your business and personal credit in good shape
Even with exhaustive preparation, businesses may still need access to additional financing in the wake of a disaster. Having good credit — both business and personal — may improve a business owner’s ability to receive financing.

“Good credit may allow you to obtain credit even when most others are being declined,” says Milani. “In addition, it may help you receive more favorable interest rates.”

5 Start building an emergency fund
Credit isn’t a cure-all. One of the most important ways a business may prepare for disruption is by building up an emergency fund. “You’ll want a minimum of three months of business expenses covered, and six months will provide even more peace of mind,” Milani says.

Preparation is the key to weathering business disruption. Learning how to leverage credit tools in times of emergency is a great start.
Best practices for managing debt

Businesses can benefit from using credit and knowing how to smartly and efficiently manage debt.

Using credit may help streamline or expand your operations, but what is an appropriate approach to the debt that can be part of using credit, based on your company’s size and cash flow needs?

Carmen Brun, senior vice president of Small Business Term Lending at Wells Fargo, says it depends on various factors, including your industry’s trends and competition. You’ll also need to evaluate if debt stemming from credit contributes to product development or value-add services to keep your business competitive.

Consider the following tips to help you take control of your business debt.

1. Identify a target payoff date

Use a debt repayment calculator to determine how long it will take to pay off your debt, based on your existing loan balance and interest rate. Explore how different monthly payment amounts may impact your total interest costs over time — you may need to adjust your payment strategy to pay off your debt within a certain timeframe. This exercise can also help gauge how taking on debt will affect you long-term and if that impact is worth it. Brun notes, for example, “If I’m going to earn an extra $50,000 a year, am I willing to spend another $20,000 a year making payments? What value is that providing?”

2. Tackle high-interest loans first

Though research suggests paying off smaller loans first can be more motivational, it’s ultimately more beneficial to pay off the loan or credit card with the highest interest rate first. This approach may save your business the most, and may allow you to pay off debt sooner.

3. Consider consolidating or refinancing high-cost debt

Over time, you may be able to take advantage of more appealing options for debt repayment. For instance, consider consolidating your debts across multiple business credit cards into a single loan with fixed rates and an established amortization schedule to pay off the debt at maturity. Similarly, a consistent record of on-time payments may allow you to refinance a loan that carries a high interest rate into a new loan with a lower rate.

Creating a strategy to repay debt may help you balance business priorities, preserve cash for other needs, and reduce your interest costs. Talk to a banker or other financial professional for guidance on forming a plan to stay on track. Consolidation and refinancing do not eliminate debt, but they may make debt easier to manage or lower your monthly payments.
My experiences with business credit

Greg Cole, co-owner of California-based pumpkin and Christmas tree retailer Seasonal Adventures, talks about the role credit has played in managing his business finances.

Wells Fargo Works: As an owner of a seasonal business, what does your approach to credit look like?

Greg Cole: Because our business is so seasonal — we’re open for 30 days for pumpkins, and then four to five weeks for Christmas time — we’ll have nice revenues for a couple months, and then sit dormant the rest of the year. And the goal has always been to be debt-free for most of that downtime.

So Wells Fargo’s credit lines are structured perfectly for us, because we need to front-load money to pay for all the rents and all the work that we do in the off-season. Generally, we start borrowing around June, and then pay it back in the third week of October.

WFW: What are the key considerations you keep top of mind when taking on debt?

Cole: I’m pretty comfortable taking on debt. At this point, we kind of know when to borrow. But generally, we aim to avoid being in any long-term debt. The number one goal is to be able to pay it back over a short period of time. Because if it rains the busy weekend of Halloween, that’s 20 or 25% of our business. The year is gone, and we don’t have any ability to recover.

It’s also helpful to spread our exposure. We were originally just in southern California, but now we have lots in Las Vegas, a lot in Boise, and one in Albuquerque. So even if we get rain in Las Vegas, we still have income from other areas. So just spreading our risk has been important to keeping the business healthy.

WFW: How have the credit products you use helped you grow your business to where it is now?

Cole: We have two credit products with Wells Fargo: a loan on the office building that we own, and a line of credit. Having that credit totally facilitated our ability to grow and increase the business over the last few years. Before we had access to money to buy equipment, we had to use our own equity lines — and at best, we would have maintained the size of our business, if not gone backward.

But now, we own our equipment free and clear. And the credit line has been the thing that has allowed us to do that.

WFW: As you keep growing and changing your business, what role will credit play?

Cole: We can see ourselves maybe five years from now being strictly in the pumpkin business — maybe keeping a couple of Christmas tree lots — because that’s where the growth is going to be. So we create a game plan for what we want to spend, how we want to grow, and we know that that growth would probably cost us $200,000 to $250,000 in equipment. Then we’d need to increase our line of credit, and would come to Wells Fargo’s door.
Next steps for business credit

A responsible, strategic approach to business credit is essential to long-term sustainability. By proactively identifying your unique business needs and goals, and how you may be able to employ credit for help meeting these needs, you can lay the foundation for the next phase of your business today.

Continue to leverage the expertise of your internal and external resources as you prepare your business for growth. Refer to this guide as needed, and work with your banker for further insights.

For discussion purposes only. All financing is subject to credit approval and, in the case of SBA loans or lines, determination of SBA eligibility by Wells Fargo SBA Lending. Additional collateral may be required.

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