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Despite economic issues, it's still the five Cs of credit

Glen J. Katlein

Given the current economic climate, I believe entrepreneurs and CEOs, with help from their CFOs, must navigate the five Cs of credit harder and better than ever. Credit is available for prudent credit risks. The challenge that can be met is how those five Cs are being scored. The same fundamental credit underwriting factors as during economic growth are still the factors evaluated to make credit decisions today. Business leaders must address how the current economic levels impact the magnitude of those factors.

Contrary to popular sentiment, lending has not hit a brick wall. B2B CFO partners across the country have helped clients close loans totaling over \$100 million since November 2008. Community and regional banks have the appetite and capital to continue lending. Major banks seem to have the appetite and capital to continue lending to existing customers. Many bankers have been contacting me expressing their interest in lending opportunities.

The same five Cs of credit still apply to determine loan approvals. They are:

- Character (integrity)
- Capacity (cash flow)
- Capital (net worth)
- Collateral (assets), and
- Conditions (borrower and economic)

Prudent credit risks based on modest underwriting scrutiny during credit expansion will still be prudent credit risks with more diligent underwriting scrutiny. Marginal credit risks approved by deteriorating lending standards during the past credit expansion will now be denied.

The first C is "character". One of my favorite inspirational thoughts is the statement about leadership that "The ultimate measure of leaders is not where they stand in moments of comfort and convenience, but where they stand in times of challenge and controversy". Our current conditions provide a great opportunity for entrepreneurs and CEOs to demonstrate their character.

Next is "capacity" or cash flow. Comprehensive cash flow tracking and forecasting is more critical than ever. More companies should be using weekly cash flow tracking and forecasting rather than traditional monthly reporting. The business leaders must make the tough decisions while demonstrating to customers, employees, and the lenders that those decisions are prudent and not risking the long term value of the company.

The "capital" or equity invested and supporting new loan decisions is likely getting more attention. The equity portion for asset-based loans is rising. Although this may be frustrating to business leaders accustomed to historical loan to value percentages, I would encourage those entrepreneurs and CEOs to put in perspective that the same equity they have and can commit to new loans will simply support somewhat lower loan balances and therefore somewhat slower growth in funded assets.



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Of course, in conjunction with less leverage is more "collateral". Whereas loans without collateral may be getting hammered, lenders are looking for opportunities with traditional collateral – receivables, inventory, and equipment. The business leaders will likely need to pay more attention to demonstrating the quality of collateral.

The most challenging factor is the current "conditions" of the company and the economy. The business leaders must be able to demonstrate strategy, action already executed and having an impact, and a reliable vision and path that the business will navigate during the current economic challenges. The question is which business leaders will demonstrate they will be successful for our next wave of economic growth. Business leaders should not let the more challenging loan underwriting scrutiny discourage them. We must simply work harder and smarter to execute the fundamentals of the five Cs of credit in order to be the winners in our economic recovery.

Coppell resident Glen J. Katlein is a partner in B2B CFO, a chief financial officer firm that provides service to emerging and mid-market companies. Katlein is currently serving as an as-needed CFO for several Dallas-Fort Worth companies. He previously spent 30 years in financial management positions with mid-market subsidiaries of companies such as Bank of America, and Citigroup (formerly Associates First Capital), and Premier Trailer Leasing. Contact Katlein at gkatlein@b2bcfo.com

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3	4	5	6	7	8	9
10	11	12	13	14	15	16
17	18	19	20	21	22	23
24	25	26	27	28	29	30
31						

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