The Looming Credit Crunch

The reasons for it are many: the savings and loan crisis, which has led regulators to tighten restrictions on all lending institutions and all types of loans; continued high federal deficits requiring the government to borrow more and more money; collapsing of the junk bond market; slowing of foreign investment in this country; and regional economic problems that put increased pressure on lending institutions. The effects are many as well: large businesses being squeezed, small businesses unable to obtain credit, some of the flamboyant speculators of the recent past, such as Donald Trump and Michael Milken, seeing their empires crumble, and individuals unable to sell their houses or obtain financing to purchase new ones.

The credit crunch is creating problems for virtually everyone. The National Federation of Independent Businesses reported that between March and May, 1990, the number of small business owners reporting credit more difficult to obtain increased by 4%. Wall and ceiling contractors are feeling the credit crunch also, and in several ways. These include closer scrutiny by banks as they try to obtain business loans to help their businesses grow; reduced opportunities in the marketplace because developers are unable to obtain loans for commercial complexes and individual homeowners can’t move up or even enter the market; and difficulty getting the money they need to keep the jobs they have going. Commercial banks and lending institutions are implementing new rules and examining new criteria for the establishment of real estate lending and contractors’ credit.

One expert says that banks are changing the way they rate loans, the way they look at collateral, and they way they look at businesses. As the economy moves into the ‘90s, some banks are demanding more collateral and are looking more closely at the applicant’s ability to repay borrowing. The American Subcontractors’ Association reports that many of its members have had their lines of credit either reduced or eliminated.

There are essentially three situations in which bankers may become extremely cautious about granting loans. The first is regional. The trend has been seen particularly in New England, primarily because of the real estate decline in that area.

The Southwest is another area that has felt the squeeze, due to economic conditions in that part of the country. The value of the collateral supporting loans has declined, and bankers are simply not convinced that some loans can be repaid.

The second situation is environmental sensitivity. Gas stations, convenience stores, and businesses that produce hazardous waste, for example, are finding it tougher to get loans these days.

Some bankers fear that those companies will be in jeopardy if the public decides to boycott their products due to environmental considerations. And they are apprehensive about the possible legal repercussions against lenders in environmental situations.

Another related factor affects all kinds of development. In many areas citizens’ groups have banded together to oppose building of all types. They are attempting a variety of strategies, ranging from efforts to pass “downzoning” legislation at the local level to court actions, even once projects are begun to boycotts and sit-ins. The end result of this is that costs for development projects increase, and because banks can no longer be sure of the final costs they tend to shy away from any projects that might face future court action or citizen protest.

The third factor has to do with industry implications. If a business is in a strong industry and applies for a loan that business is more likely to get the loan than one from a weaker industry. With money fairly tight now, that could make a difference in some cases.

Over and above the three factors, bankers are approaching lending from a slightly different perspective than in years past. The whole scenario has changed. In the early ‘80s, for example, bankers looked mainly at collateral. If a business applied for a loan, the bank would look at things like accounts receivable and inventory. They would lend money against those criteria. In the mid-‘80s, banks tended to look at cash flow. If a business had enough money to cover the bills, pay employees, purchase inventory, repay borrowing, and still make a profit, that business could usually count on getting a loan.

By the ‘90s, bankers are looking at a company’s overall strategy and operational effectiveness. Banks want to know much more about how a business is operated. They tend to look more favorably on those with a focus or plan.

To improve the odds when applying for a loan, here are some suggestions:

—Visit the bankers you have obtained loans from and repay in the past first. Obviously, banks will look favorably on a successful track record, and if you are known to them, so much the better.

—Get a business plan if you do not already have one. Your business plan needs to deal with your strategy, how you implement that strategy, and the results you hope to achieve. It should consist of a marketing plan that is integrated with a financial plan, and, if you have a strong balance sheet, it will be looked on favorably in any industry.

Bankers today are asking themselves, “What if I owned this company? They’re no longer looking at just collateral and cash flow. Bankers need to see a successful business, with a good, strong balance sheet, a clearly defined strategy, and effective operations.

Regulatory agencies that keep an eye on banks are putting pressure on lenders to run their businesses better. That, in turn, is causing bankers to scrutinize borrowers much more carefully. The trend is likely to continue well into the decade.