

# **IV. Financial Management**

## **Topic 41**

### **How to Obtain Credit or a Loan**

# FACT SHEET

## IV. Financial Management

### Topic 41: How to Obtain Credit or a Loan

Credit and loans are ways to establish or expand your business.

There are always two parties:

- **Creditor:** Provider of the money, good, or service
- **Debtor:** Recipient of the money, good, or service

**Credit** can be provided by:

- Importers of agro inputs
- Transporters
- Any other provider of goods or services

There are several sources from which to obtain a **loan**:

- Informal
  - Produce buyers
  - Village money lenders
  - Ajo/Esusu club
  - Friends and relatives
- Formal
  - Coop societies (credit and thrift)
  - Commercial banks
  - Projects
  - Public sector financial institutions:
    - NARCDB
    - BOI
    - State Credit Corp
    - Federal Mortgage Bank

### **To seek credit or a loan, you must:**

#### 1. **Be prepared:**

- **Register your business** (acquiring a legal status).
- Have **good savings habits** and maintain a regular savings account with a bank.
- **Keep records** of your current and past financial transactions, especially financial records.



- Have a **business plan** or at least an idea of how the money will be spent, and how it can generate revenues. Also know the amount of goods that are needed, and the way the loan or credit will be repaid.
2. **Identify** the best bank, financial institute or service provider to approach.
  3. **Approach** the bankers or service providers to discuss the credit or loan needed and the terms. When applying for credit or a loan, you need to know the following:
    - Interest: how much is the interest rate you have to pay on top of your credit?
    - What are the conditions to apply for a loan or credit?
  4. If in agreement, **complete** the necessary forms or documents.

After you have completed all the necessary forms and documents, the creditor (the bank, financial institute, or provider) **appraises the application** and decides if you will use the credit well and repay within the stipulated period.

Creditors usually conduct a **detailed analysis** of all applications to determine your ability to repay. They generally consider the following:

- Applicant's bio-data: sex, age, education, work experience.
- Business data: core business (what are you selling?), credit history, accounts (financial) and records.
- The project: how is the credit going to be used?
- Cash flow projections: how much money will come in and what will be spent? How is income generated? What are the projections for different scenarios?

# ADDITIONAL INFORMATION

## IV. Financial Management

### Topic 41: How to Obtain Credit or a Loan

#### Credit or loans:

- Can be used to start or expand a business, enlarge stock, make any other investments.
- Have a definite lifespan, which is the period it is initiated or given until when it is repaid under specified conditions.
- Have to **always** be (re)paid.
- Come at a price: interest.

To seek credit or a loan, an entrepreneur must:

1. **Be prepared:**
  - a. **Register the business** (acquiring a legal status): Even if an entrepreneur would like to buy something on credit, he/she must register his/her business. It shows that the entrepreneur is serious and professional.
  - b. Have **good savings habits** and maintain a regular savings account with a bank. If an entrepreneur is of good standing, the bank or creditor is much more likely to give a loan or credit for a second time. In general, a good image is difficult to build and only takes a few seconds to destroy. If an entrepreneur fails to repay his/her credit or loan, the bank creditor will probably not give a loan or credit another time.
  - c. **Keep records** of current and past financial transactions, especially financial records (cash-inflows and out-flows). It shows that the entrepreneur is serious and accountable. Keeping records and showing them to a banker or supplier imply that there is nothing to hide. It also shows that the entrepreneur knows how to handle his/her capital and business.
  - d. Have a **business plan** or at least an idea of how the money will be spent, and how it can generate revenues. Also know the amount of goods that are needed, and the way the loan or credit will be repaid.
2. **Identify** the best bank, financial institute, supplier or service provider to approach.

3. **Approach** the banker, supplier, or service provider to discuss the credit or loan needed and the terms. When applying for credit or a loan, an entrepreneur needs to know the following:
  - Interest: how much is the interest rate to be paid on top of the credit?
  - What are the conditions to apply for a loan or credit?
4. If in agreement, the entrepreneur must **complete** the necessary forms or documents. This is different for every bank or creditor. An importer of agro inputs or a transporter may want to sign a contract, while a bank or financial institute may want a completed application form. The conditions for application are also always different.

➔ **Other important information:**

- **When** to seek credit is very important. Credit should be obtained when optimal use or advantage can be maximized (for example, a few weeks before the season starts).
- Usually the project is **analyzed** to determine its social and economic viability according to the following indications:
  - Profitability
  - Re-payment schedule (realistic and convenient)
  - Social and economic environment
  - Infrastructural facilities (adequacy)
  - Demographic factors
  - Cultural and legal restrictions
  - Type of project

Five major criteria of credit or loan appraisal are used to assess all requests by creditors at the individual or sole proprietor level:

- **Character:** applicant's reputation, and records that indicate lawsuits or criminality.
- **Capacity:** extent of experience in business, mental and physical stability, income, age, credit record, etc.
- **Collateral:** availability of assets to pledge in order to redeem the credit or loan in case an attempt to recover fails.
- **Conditions:** cash flow forecast and profitability indications.
- **Capital:** assets or total net-worth indications, liquidity ratio, account receivables, etc.

➔ **Some cautions:**

- A loan or credit naturally and in most cases **increases the cost** of doing business, because interest has to be paid. Entrepreneurs should carefully appraise when and what type of loan or credit to seek, should minimize costs, but maximize profit in the long term.



- **Interest** on loans and credit can be very different, even among financial institutes. Therefore, an entrepreneur should look for the best option.
- No creditor will give an entrepreneur goods or render services, without knowing that he/she has good banking or savings habits.

# INSTRUCTIONS

## IV. Financial Management

### Topic 41: How to Obtain Credit or a Loan

#### Materials needed:

- Flip-sheet board with flip-sheets
- Markers (1 black, 1 blue, 1 green, 1 red)
- Colored cards

**Time needed:** 1 hour

**Preparations:**  Colored cards with the following text:

- *be prepared*
- *identify*
- *approach*
- *complete*

### Set up

**Attention:** Ask if anyone has ever taken a loan or credit. Let them raise their hands.

**Title:** Tell the title of this session: *How to obtain credit or a loan.*

**Credibility:** Explain your (the trainer) experience with credit and loans.

**Objectives:** During this session we will explain the difference between credit and loans, and how you can apply.

**Benefits:** If you know all the steps to take, you are much more likely to get a loan or credit.

**Direction:** This is only theory; we are not going to actually apply for a credit or loan.

## Delivery

### Explanation, Demonstration, Exercise and Guidance:

1. Start with a small recap of the session on basics on financial management. Ask if someone can repeat the difference between a loan and credit. A **loan** is money you can borrow from someone, a bank or any other financial institute. **Credit** means that you purchase items or goods that you collect right away, but you will pay at a later period.
2. Ask if anyone can indicate **why** it is useful to apply for credit or a loan. With credit or a loan an agro input dealer can invest in his/her business (for example, by buying stock and selling it for a profit, expanding the business, etc.). A loan or credit should always be used to make more money.
3. Ask where or from whom we can get **credit**. List all answers on a flip-sheet. The following can be mentioned:
  - Importers of agro inputs
  - Transporters
  - Any other provider of goods or services
4. Ask where or from whom we can get a **loan**. List all answers on a flip-sheet. The following can be mentioned:
  - Informal
    - Produce buyers
    - Village money lenders
    - Ajo/Esusu club
    - Friends and relatives
  - Formal
    - Coop societies (credit and thrift)
    - Commercial banks
    - Projects
    - Public sector financial institutions:
      - NARCDB
      - BOI
      - State Credit Corp
      - Federal Mortgage Bank
5. Split participants in groups of not more than five per group. Tell them that each group is representing an agro dealer. Let half of the groups brainstorm on steps to take when applying for a loan with a financial institute (such as rural banks) and let the other half brainstorm on steps to take when applying for credit with a major importer of agro inputs. Tell the groups to list the steps in their notebook.
6. Ask one of the groups that discussed loans to mention a first step. Ask if the other groups agree, including the groups that discussed credit. If everyone agrees, and

indeed, it is the first step, paste the colored card with *be prepared* on the board and discuss the steps that fall under that category, such as:

- a. **Register the business** (acquiring a legal status).
- b. Have **good savings habits** and maintain a regular savings account with a bank.
- c. **Keep records** of current and past financial transactions, especially financial records (cash-inflows and out-flows).
- d. Have a **business plan** or at least an idea of how the money will be spent and how it can generate revenues. Also know the amount of goods that are needed, and the way the loan or credit will be repaid.

Note: If a group mentions step 2 or even step 3 (for example *identify the creditor* or *approach the creditor*), list the step on the board under number 2 or 3, and discuss. After the discussion, tell participants that you still miss a step (or two) that comes before the step that was mentioned.

7. Now ask a group that discussed credit for the second step. Continue until all steps are discussed. Make sure you alternate between the groups that discussed loans and those that discussed credit. Tell participants that the steps are the same and only the details are different. For example with a loan you need to think ahead of how much money you are requesting, and how you are going to use this money. With credit you need to know what you want from the service provider (how many goods, what type of service) and you have to estimate the profit you will generate to repay your credit.
8. The steps are:
  - a. **Be prepared**
  - b. **Identify** the best bank, financial institute or service provider to approach.
  - c. **Approach** the bankers or service providers to discuss the credit or loan and the terms. When applying for credit or a loan, you need to know the following:
    - a) Interest: how much is the interest rate you have to pay on top of your credit?
    - b) What are the conditions to apply for a loan or credit?
  - d. If in agreement, **complete** the necessary forms or documents.
9. After all steps are listed, conclude by saying that for all loans and credit, it is important to **repay**. If you do not repay, you may **never** receive a loan or credit again. If you repay your loan or credit on time, the creditor will have confidence in you and is much more likely to give you a loan or credit a second time.

## Finish

**Summary:** Tell participants the four steps to take when applying for a loan or credit.

**Questions:** Ask if anyone has a question or comment.



**Evaluation:** Ask what steps should be taken when applying for a loan or credit.

**Next step:** Now that the participants know the steps to apply for a credit or loan, they should have no excuses for not trying.

Distribute the **fact sheet** to all participants.