



## How to Get Your Business Credit Line Increased

By FocusCFO

Renewing or increasing a bank Line of Credit (LOC) can pose a significant challenge for businesses today. Being a good customer, meaning that you have a history of making your payments on time, is not necessarily enough to warrant extended credit. In today's banking environment, many other factors have become part of the credit underwriting process.

It is common practice today for banks to analyze overall credit worthiness, collateral, and cash flow when making credit decisions; therefore, it is critical for business owners to understand their Balance Sheet, Income Statement, and Cash Flow Statement, particularly cash flow from operations.

We will discuss the following key factors that business owners should consider when seeking an increased bank Line of Credit:

1. How much is needed, why is it needed, and how much of it will be used
2. What are the financial covenants and can your business meet them
3. Your business collateral
4. Communication with your bank

### How Much is Needed, Why, and How Much Will be Used

To calculate your funding requirements, you need a twelve-month cash flow forecast that incorporates accurate projections for key cash flow inflow and outflow sources. The specific amount of funding required can only be

determined by also including the fluctuations in all Balance Sheet accounts. Knowing how much you need and documenting your method to determine that amount will demonstrate your business credibility to the bank, and therefore increase your likelihood of approval.

The true purpose of a Line of Credit is to fill the funding gaps that occur due to the cyclical nature of a business caused by increases in accounts receivable and increased inventories that are due to increased sales, or by (preferably not) slow paying customers or obsolete inventory. Lines of Credit should never be used for the purchase of long-term assets or to fund losses. These amounts generally can't be repaid within one year, which is the typical preference of banks. If your outstanding balance does not significantly fluctuate, it will be an indicator to your bank that your Line of Credit is not being used for cyclical funding gaps.

It is important not to request more financing than you really need. Accurate and expert cash flow analysis is the only way to determine this amount. If you ask for more financing than you need, the bank will question your competence; their confidence in you as a business owner is an important factor in their decision-making process.

## What are the Financial Covenants

Virtually every Line of Credit comes with financial covenants, which are conditions of your funding and benchmarks that you must achieve. It is essential to understand these covenants and to comply with them. The most common covenants are working capital, liquidity, and debt coverage, but they can include anything else the bank considers relevant to risk, such as owner compensation, capital spending, retained earnings, owner distributions, tangible net worth, and more.

## Collateral

While cash flow is the main focus of banks, collateral is also of primary concern, and banks never lend 100% of the value of any collateral. Typical collateral for Lines of Credit includes qualified trade receivables and inventory. It is important to understand how banks define qualified collateral, and how to calculate its value.

## Communication

The business owner's communication with the Banker is probably the most important and yet understated factor that the business owner must focus on – not just when trying to increase a Line of Credit – but all of the time. You need to have an ongoing relationship with your banker, and not just talk to them when you need to borrow money. Another important factor related to communication is providing the banker with documents that are required based on your financing agreements on a timely basis. Sometimes, not providing the information can cause a default of the loan, and it is your responsibility to provide that information and to make the banker's job as easy as possible. This is a critical function of your CFO.

If you, as a business owner, want to increase your Line of Credit, you need to understand the requirements and why they are in place. Banks want to lend money, but only for the right purposes and only when they are confident that it will be paid back. Having the right documentation in place to prove that you manage your business and your cash flow effectively will show your bank that you are a good candidate for additional credit.

***Founded in 2001, FocusCFO is the leading onsite fractional CFO services provider in the Midwest and Southeast, with more than 100 CFOs and Area Presidents throughout Ohio, Michigan, Kentucky, Indiana, Pennsylvania, Tennessee, and North Carolina. FocusCFO works closely with small to medium sized businesses helping business owners gain control over three key financial and operational areas: increasing cash flow, reducing business risk, and creating a platform for scalable growth. This allows business owners to then realize full financial control and increased value in their businesses.***

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