8 business loan requirements, and application pitfalls to avoid

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What is in this guide?

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Like with consumer lending products, business loan requirements weed out risky applicants and determine who receives the most attractive interest rates and terms.

If you have good credit and stable financials, you're more likely to receive funding and have lower borrowing costs. If you don't, you might strengthen your application through other requirements for a business loan, perhaps by demonstrating strong sales figures and cash flow or by putting down money or collateral for secured financing. You might even write a persuasive business plan or loan proposal.

There are other key small business loan requirements to consider. Here's what to know before you apply.

1. Credit scores

Common lender criteria: Credit score requirements are typically in the 600s, although loans for bad credit are available.

Your personal and business credit scores are the more direct indicators to lenders of your and your business's track record of handling debt. If your credit reports show a history of on-time payments, conservative credit usage and a diversified credit mix, you're more likely to gain loan approval and at competitive interest rates.

Tip: While you can check your personal credit scores via your financial institution or a third-party monitoring service, find your business scores via the main business credit bureaus — Dun & Bradstreet, Equifax and Experian — with FICO, among other options.

If you have bad credit scores or a thin credit history, some lenders may find ways to offset this requirement, such as imposing higher interest rates or requiring a personal guarantee.

What if you don't meet this requirement? If your credit scores are less than stellar, consider pausing your application to focus on improving your credit. You can make several months of on-time payments to impact your payment history, and pay off credit cards to lower your credit utilization. If time isn't on your side, consider finding a cosigner with better credit.

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2. Gross revenue

Common lender criteria: You may be required to show your business's sales or revenue numbers. This business loan requirement varies by lender — it could be anywhere from $5,000 to $25,000 or more per month — and may also depend on how long you've been in business.

Like credit scores, revenue is a barometer for your business's health. If you've been in business for a short time, lenders may allow you to provide monthly income figures, but most are seeking annual revenue totals, ideally in the six figures. SBA.gov publishes its average annual receipts targets online.

Keep in mind that larger loans may carry higher annual minimums, with some lenders looking for upwards of $250,000.

What if you don't meet this requirement? Not all lenders have high minimum revenue requirements. Some lenders specializing in small businesses have four-figure annual minimums that more closely align with the borrowed amount. Look for microlenders or other alternative lenders if you need to get a business loan with no money saved.

3. Years in business

Common lender criteria: Traditional lenders, like banks, typically require businesses to be at least two years old. However, many online lenders will accept a minimum of six months in business.

A business's operating time goes hand in hand with its revenue: It shows that it's on track to succeed or at least persevere. If you have a startup, expect to have a more difficult time qualifying or nabbing low rates and attractive loan terms.

There may be related requirements for the size of your business. SBA loans, for example, set requirements for a business's number of employees; view the standards at SBA.gov.

What if you don't meet this requirement? Given their nonprofit and member-owned status, credit unions could be your best bet for more flexible business loan requirements, said Jason Pendergist, chief lending officer at Kinecta Federal Credit Union. You might also consider the best startup business loans.

4. Industry type

Common lender criteria: Some industries — such as gambling, adult entertainment and cannabis — aren't eligible for government-backed loans.

The Small Business Administration (SBA) has a list of ineligible businesses that include:

- Lenders
- Financial companies
- Life insurance
- Live adult entertainment
- Gambling
- Political lobbying
- Speculative (or high-risk) businesses

Not all loans are governed by the SBA, but many financial institutions use similar guidelines. Some lenders have even more restrictions, so check eligibility requirements carefully.

What if you don't meet this requirement? If your industry is on the no-fly list, consider crowdfunding or lenders specializing in regulated industries.

5. Business plan

Common lender criteria: A business plan — how you plan to employ loan funds to further your cause — is standard for loan applications.

A business plan shows that you have researched demographics and competitors and have tactics for hitting your sales goals. Even (perhaps, especially) new companies should have a plan showing their viability in the marketplace. You can find business plan templates and advice via the SBA.

Good to know: Loan proposals are similar to business plans, although they may be abbreviated to focus solely on securing funding.

Your business plan should include:

- Executive summary of your business and its goals
- Detailed company description
- Organizational structure, or how your business will be run
- Market analysis of who's buying and who else is selling
- Spotlight your primary product or service
- Marketing plan, or how you'll sell your product
- Funding plan, or how much you need to borrow and why
- Other documents, such as financial statements and expense reports

What if you don't meet this requirement? If you're unwilling to create a business plan, you'll likely need to search for alternative funding sources, such as crowdfunding or online lenders.

6. Down payments or collateral (for secured loans)

Common lender criteria: Some loans don't require down payments or collateral. However, many term loans, including the SBA-guaranteed 7(a) loans, insist on them, at least for loans over a certain threshold ($50,000 in the case of 7(a) loans).

It seems counterintuitive to fork over cash for a loan, but many business loans require a 10% down payment (or equity in the loan). This initial payment shows that the business is financially solvent and trustworthy. The amount of the down payment varies by lender.

In place of a down payment, some lenders accept collateral, such as real estate, equipment, accounts receivable or inventory.

While down payments and collateral are different, the mechanism is the same: The lender secures their investment with either cash or items of value.

What if you don't meet this requirement? If you can't afford the down payment or don't have sufficient collateral, seek out an unsecured business loan.

7. Personal guarantee

Common lender criteria: Lenders may require that your business loan be secured by a personal guarantee that the funds will be repaid, even in the event of business closure.

Some unsecured (and even secured) business loans require a personal guarantee, which promises you'll repay the loan even if your business fails. Under the terms of the guarantee, the lender may require payment from your personal assets.

Good to know: You must provide an unconditional guarantee for SBA loans if you own at least 20% of the business applying for funding.

Signing a personal guarantee isn't necessary for every loan and should be avoided if possible. If you agree to a personal guarantee, even businesses with legal structures intended to protect personal assets, like a limited liability company (LLC), aren't protected.

What if you don't meet this requirement? Look for lenders that don't require a personal guarantee, or negotiate a limited personal guarantee during the contract portion of your loan process. Secured loans are less likely to contain this requirement.

8. Debt-to-service coverage ratio

Common lender criteria: Lenders usually look for a debt-to-service ratio (DSCR) of close to 1.25, but the higher, the better. SBA loans require a DSCR of 1.15 or above.

Your DSCR indicates whether you have the available capital to make new loan payments. A low ratio means that you're already overextended.

Calculate yours by dividing your "earnings before interest, tax, deductions and amortization" (EBITDA) by your total annual debt payments. For example, if your EBITDA is $200,000 and your debt is $160,000, your DSCR would be 1.25 ($200,000 / $160,000).

The greater the gap between what you earn and what you owe, the more likely you are to secure new debt.

What if you don't meet this requirement? If your DSCR is low, consider paying off existing debt before applying for new debt.

Gather these 4 required documents before applying

Lenders pull your personal and business credit scores when you apply, but you'll also need to gather several financial documents for evaluation. Even so-called no-doc business loans require at least a little supporting documentation.

1. **Business bank statements:** Reviewing your company's bank statements allows the lender to see how much cash you currently have in reserve, as well as your income and expenses over the last year or two.
2. **Financial statements:** Your business's income statement shows whether your company meets the lender's revenue requirements. Lenders may also require balance and cash flow statements.
3. **Federal tax returns:** These help verify the revenue information you provide.
4. **Legal documents:** Expect to show that your company is legally incorporated and

complying with federal and state guidelines. You may need to submit copies of your business license, articles of incorporation and any other legal documents such as commercial leases.

Pulling this information together in advance of starting your business loan application helps streamline the process so you can receive a funding decision as soon as possible. And if you receive requests for additional information from your lender, respond as quickly as possible. Effective communication plays an important role in getting your funding request approved.

How to find a good business loan

Knowing where you stand against small business loan requirements is a great start. But to find the best loan for your situation, stop and ask yourself three questions:

1. **How much do I need?** Your total loan amount may determine whether you're eligible for a microloan or whether peer-to-peer lending or crowdfunding makes more sense.
2. **What do I need it for?** Some business loans restrict how you use the funds. For example, an SBA microloan may not be used to purchase real estate but can be used for operating costs. Equipment loans or real estate loans may also offer different collateral options.
3. **Am I ready to take on new debt?** Do you have good credit scores, or do you need to explore alternative funding options? If your cash flow is already tight, your options may be limited.

After determining your needs, you may be more ready to apply for a small business loan. While large national banks are often the first stop, Pendergist said that local credit unions may be a more viable option.

"Credit unions often have more flexibility to build a one-on-one relationship with each client and the ability to offer creative loan structures with more competitive rates," he said.

Beyond banks and credit unions, look for competitive interest rates and reasonable repayment schedules from the best small business loans offered by online lenders or peer-to-peer lending platforms.

No matter the lender type you choose, read your loan agreement carefully and understand what you’re signing, especially when your personal and business assets are on the line.

5 common business loan application mistakes

1. Not allowing enough time

It takes time for lenders to process and approve business loan applications, so don’t wait until the last minute if you have time-sensitive needs. Budget for at least 60 to 90 days, said James Lichau, a California-based certified public accountant (CPA).

“Plan ahead to avoid any potential cash flow issues or to align project planning, depending on the reason for taking the loan,” Lichau said. And if you’re planning to apply for an SBA loan, you can expect the process to take even longer.

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2. Failing to provide the necessary documents

Submitting accurate and thorough documentation with your loan application helps the lender feel confident that your business can make the payments according to schedule. Consider having your financial statements vetted by a professional.

“Preparing a detailed cash flow analysis that has been reviewed and vetted by your CPA and banker will help you avoid issues or questions during the underwriting process that could potentially delay the lender funding loan,” Lichau said.

3. Being unclear on the use of funds

“The lender needs to know more than, ‘I need $100,000 in working capital,’” explained Catherine Riddle, business consultant and former lending executive. Riddle recommended articulating how the extra funds will help generate additional sales and earnings since that demonstrates your ability to repay the loan.

4. Omitting financial projections

Demonstrating how you expect revenue to grow over the loan term can help improve your chances of approval. Be realistic with your projections, said Riddle.

“The financial projections should reflect a justifiable path stemming from the injection of cash that shows the business will generate profits to repay the loan,” she said. If your business plan can’t demonstrate an increase in profits as a result of the business loan, you may struggle to qualify for financing.

5. Leaving out existing debt

Lenders need to see both your business assets and liabilities in order to make a financing decision. Riddle recommended including a current debt schedule and repayment requirements.

“The lender will need to understand other principal payments that are due and what assets might be encumbered by the existing debt,” she said. This information helps lenders determine your financial capacity. For every $1 of debt service (or the amount of cash required to repay all current debts), you may need to have $1.25 in income to cover the cost and have a cushion.

Additional reporting by Lauren Ward

Frequently asked questions (FAQs)

Can I get a business loan with a bad credit score?

Credit unions may be more likely to work with businesses with bad or limited credit, as they focus on supporting community members, according to Pendergist. You might also make up for a thin credit history or poor credit scores by supplying a down payment or collateral on a secured loan, or by demonstrating a high revenue and debt-service coverage ratio.

How long does it take to get a business loan approved?

Do I need to provide personal guarantees for a business loan?

What happens if I default on a business loan?

What are some alternatives to business loans if I can’t qualify?

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