Article 27, 31.01.2025/NMP_IMCI+ Alliance
Credit Scoring Process & Methods for SMB Loan Applications
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Introduction

The **Credit Scoring Process** within the Loan Application will define the success of the final decision of the bank and lending party. **IMCI+**, acting as an underwriter and advisor in the process, supports corporate loan applications efficiently.

It is essential for applicants to understand the **mechanics of creditworthiness and the credit scoring system**. This article explains the **mechanism and examples** that may be useful in the loan application process if you require funding services from one of our **certified IMCI+ Alliance Members**.

1. Overview of Credit Scoring in SMB Loan Applications

Credit scoring is a systematic process that evaluates the **financial health and creditworthiness** of small and medium-sized businesses (**SMBs**). It helps lenders assess lending risks and determines:

- **Loan eligibility**
- **Interest rates**
- **Repayment terms**

The credit scoring process for SMBs involves **quantitative** (financial) and **qualitative** (non-financial) factors analyzed through various scoring models and frameworks.

2. Credit Scoring Process in SMB Loan Applications

Step 1: Pre-Screening of the Loan Application

Before performing a detailed credit evaluation, lenders conduct a **preliminary screening** to determine whether the applicant meets basic loan criteria. The pre-screening includes:

- **Business Age & Registration**: Many lenders require SMBs to be operational for at least **1-3 years**.
- **Minimum Revenue Requirement**: Lenders may set a threshold (e.g., **$5,000,000+ annual revenue**).
- **Industry Type**: Some industries are considered **high-risk** (e.g., hospitality, startups).
- **Loan Purpose**: Capital expenditures, working capital, expansion, refinancing, etc.

If the business meets these criteria, it moves to the next stage.

Step 2: Collection of Business & Financial Data

Lenders require **detailed business and financial documents**, including:

A. Business Profile & Ownership

- Business registration documents (**LLC, Corporation, Sole Proprietor, etc.**).
- List of owners and percentage of ownership.
- Articles of incorporation and business licenses.
- Industry type, years in business, and number of employees.

B. Financial Statements & Credit History

- **Income Statements & Profit & Loss Statements** (last **3-5 years**).
- **Balance Sheets** (last **3-5 years**).
- **Cash Flow Statements** to analyze liquidity.
- **Tax Returns** (business and personal if required).
- **Bank Statements** (**12 months to 3 years**).
- **Accounts Receivable & Payable** to assess cash cycle and credit obligations.
- **Debt Schedule** to analyze existing liabilities and obligations.
- **Credit Bureau Reports** (**business and personal**).

C. Collateral Information (if required)

- **Valuation reports** for fixed assets (**real estate, equipment, inventory**).
- **Ownership documents** for pledged assets.
- **Insurance coverage details** on assets and liabilities.

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Once the required information is collected, the lender moves to **credit scoring**.

Step 3: Application of Credit Scoring Models

Lenders use different **credit scoring models** to assess financial health and creditworthiness.

A. Quantitative Credit Scoring Methods (Financial Analysis)

1. **Credit Bureau Score** (FICO, Experian, Dun & Bradstreet, etc.)
   - **80+ (D&B Paydex Score)** – Strong creditworthiness.
   - **50-79** – Medium risk.
   - **Below 50** – High risk.
2. **Debt-to-Equity Ratio (D/E Ratio)**
   - **D/E Ratio** = Total Debt / Total Equity
   - **Lower ratio (<2.0)** = Financially stable business.
   - **Higher ratio (>3.0)** = Higher financial risk.
3. **Debt Service Coverage Ratio (DSCR)**
   - **DSCR** = Net Operating Income / Total Debt Service
   - **DSCR > 1.2** is preferred for loan approval.
4. **Liquidity Ratios** (Current Ratio & Quick Ratio)
   - **Current Ratio** = Current Assets / Current Liabilities
   - **Quick Ratio** = (Current Assets - Inventory) / Current Liabilities
   - **Ratios above 1.5** indicate strong liquidity.
5. **Altman Z-Score** (Bankruptcy Risk Prediction)
   - **Z-Score > 2.99** = Safe zone.
   - **Z-Score < 1.81** = High bankruptcy risk.

B. Qualitative Credit Scoring Methods (Non-Financial Factors)

1. **The 5 Cs of Credit**
   - **Character**: Owner's credit history, experience, and business ethics.
   - **Capacity**: Ability to generate cash flow and repay the loan.
   - **Capital**: Business investment and financial stability.
   - **Collateral**: Assets pledged to secure the loan.
   - **Conditions**: Market, economic, and industry conditions.
2. **Business Plan, Feasbility Studies, Marketing Studies, Risk Framework & Management Experience**
   - Strong management teams **increase creditworthiness**.
   - Well-documented **business plans, feasbility studies, marketing studies, risk managemetn framework, ESG, can improve scoring**.
3. **Industry & Economic Trends**
   - Lenders assess **macroeconomic conditions affecting the industry**.

Step 4: Credit Risk Classification & Decision Making

Based on the scoring results, the lender categorizes SMBs into **risk levels**:

Risk Category	Credit Score Range	Loan Approval Probability	Typical Loan Terms
Low Risk	**750-850 (FICO) / 80+ (D&B)**	**High**	Low interest, flexible terms
Moderate Risk	**650-749 (FICO) / 50-79 (D&B)**	**Conditional approval**	Medium interest, some collateral
High Risk	**< 650 (FICO) / < 50 (D&B)**	**Low**	High interest, strict terms or rejection

The final decision includes:

- **Approved** → Loan terms (amount, rate, tenure).
- **Conditional Approval** → Additional documents, collateral.
- **Rejected** → Reasons provided, possible restructuring options.

Step 5: Loan Disbursement & Monitoring

If the loan is **approved**, funds are disbursed, and **post-loan monitoring** occurs through:

- **Periodic financial reporting**.
- **Compliance with loan covenants**.
- **Continuous credit score monitoring**.
- **Site visits and operational assessments**.

Conclusion

Credit scoring in SMB loan applications involves **both financial and non-financial evaluations** to assess risk. Lenders use **quantitative models** (FICO, Altman Z-Score, DSCR, etc.) along with **qualitative factors** (5 Cs of Credit, business stability, industry conditions) to make loan decisions. It is important that the loan application is well prepared for this path and covers the necessary premises.

Would you like **IMCI+ to assist in your funding application? Contact us today!** info@imci-group.com