Top 7 Equipment Financing Mistakes

Help your business avoid the most common equipment financing mistakes.

Not investigating all your options. Many business owners make the mistake of thinking the bank with which they have their checking account is the only option for equipment financing. In reality, equipment financing can come from several sources including banks, finance companies, credit unions, and captive financing (equipment dealer or manufacturer). If your business is serious about acquiring new equipment, research all your options. By exploring the various financing options available, your business can secure financing terms, conditions, and cost that better meet its needs.

Not knowing your lender.
Remember, you are entering into a long-term relationship when you finance equipment. If you are not familiar with a potential lender, ask them for references. Ask your equipment vendor who they recommend for financing. Find out if your lender is self-funded or a broker. Direct lenders typically retain the servicing of your loan or lease. Brokers simply act as a middle man in placing your deal with a larger lender. Most importantly, make sure you know whom to call with future questions, comments, and concerns.

Tip Check out your lender's Better Business Bureau rating (www.bbb.org/us) prior to entering into any new borrowing relationship.

Entering with unrealistic expectations. The cost of your financing should be directly related to your overall credit quality. The lower your credit risk, the lower your financing cost. Applicants with a poor quality credit history often do not qualify for the lowest cost financing. Prior to applying for financing, you should access your credit report and familiarize yourself with your personal credit scores. Understanding whether your credit is strong, mediocre, or weak will allow you to set reasonable expectations. If there are any errors in your credit report, you should try to correct them before seeking financing. Also, by knowing your FICO, you will know what the lender will be looking at, so that he or she cannot tell you your number is lower than it actually is.

Using rate tunnel vision.
Your monthly payment is only part of the overall financing equation. There are many additional factors that will influence the quality of your financing including, but not limited to the following: all-in initial cash requirement, term, end-of-term obligation, pre-payment penalty, equipment upgrade options, potential fees, etc.

Not balancing cost and cash flow. Most equipment buyers don't want to pay too much, but they also want a low monthly payment. If you select a term that is too short, you save money but at a great sacrifice to your cash flow. If you select a term that is too long, your cash flow benefits because of a low monthly payment but you may pay too much. The key is to find the proper balance that satisfies your business' cost and cash flow requirements.

Not insisting on getting it in writing. There are many variables and conditions contained in the standard equipment financing contract. Don't cut corners by choosing a lender based on a "verbal" quotation only. Require your potential lender to provide you with a written financing proposal that, at minimum, provides you with your all-in initial cash requirement, monthly payment, term and end-of-term obligation. Also require your lender to clarify who will be servicing (sending you monthly invoices) your loan or lease. Finally, read your equipment financing documentation to avoid potential surprises.

Not determining what you can comfortably afford. Unlike a home mortgage, in which people look long and hard at what they will be able to pay over the next 10 to 30 years, equipment buyers do not always make the same consideration. "It is only for five years" is a familiar excuse for not evaluating the impact of such payments on your budget. Before buying equipment, you need to consider how much money you can put down, and what type of cash flow you anticipate to generate from the equipment you are acquiring.

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