What Happens When You Default on a Business Loan? Plus, How to Avoid It

Every entrepreneur at some point considers or already has taken a business loan. Everyone has the best intentions of paying back the loan. However, due to situations like a sudden decline in sales, miscalculations, or other unforeseeable circumstances, your finances take a hit and you do not make your monthly instalments on time. This could cause you to default on your business loan. Defaulting on a business loan is humiliating and a major setback for the business.

**Definition of loan default:**

In simple words, a loan default happens when a borrower breaches a decided term of the loan agreement. Generally, this occurs when a borrower does not make the agreed upon instalment payments. This results in the lender resorting to legal action against the borrower.

**Results of defaulting on a business loan?**

The repercussions vary as per the terms and conditions of the business agreement. Below is a list of consequences of defaulting on your business loan.

* **Drop in credit score**

Every time you miss an instalment the lender reports you to credit agencies. This leads to a drop in your credit scores, which jeopardizes your chance of being approved for any loan in the future.

* **Increased rate of interest**

Once your **credit score** drops, depending on your business loan agreement your interest rates will increase or you will be charged an exorbitant late fee. This will affect your current loan repayment and possible future loan approvals.

* **Legal Action or foreclosure**

In case of a business loan default, depending on whether you have applied for a secured or unsecured loan, the consequences vary. In a secured loan, a foreclosure will allow the lender complete authority of all your assets and properties mentioned as collateral in your loan agreement. Generally, they sell the collateral in a private or public auction to recover their losses.

In the case of an unsecured loan, the lender generally charges you a late fee. However, even in the case of an unsecured loan, the lender requires a personal guarantee or a lien to your business assets. Therefore, on further failure, the lender can file a lawsuit against your business.

* **Difficulty in getting approved for loans in the future**

Once you default on a loan coupled with bad credit score, it is extremely difficult to procure any loan in the future. You will have to look for alternative ways to fund your business.

* **Declaring bankruptcy**

If you default on your loan, the lender will start legal proceedings in order to recover the loan amount. In case of secured loans, the collateral will be seized. For unsecured loans, as discussed earlier, lenders will sue you for defaulting on the loan. As per the courts ordered method the loan will be recovered. However, if the lender is still not able to recover the loan amount then your business may have to file for bankruptcy.

As seen above, defaulting on your business loan has adverse long-term and short-term effects. There are numerous available options in case you are finding it difficult to repay your loan. Below are a few pointers that would prevent you from defaulting on your business loan.

* **Maintain sufficient balance**

Always maintain a sufficient balance in your bank account to avoid missing loan payments. A business is always subject to volatile market conditions. Therefore, it is advisable to allow yourself some headroom. Maintain a reserve of at least 3 months’ worth of repayment in your account.

* **Be aware of your dates**

Always know the due dates of your instalments. It ensures that you have the required amount in your account. Also, it helps you plan your finances better in case of other expenses incurred in your business or other loans. Even if you miss an instalment, it does not immediately make you a defaulter. However, it may result in late fines.

* **Refinance**

Short-term loans tend to kill the momentum of upcoming businesses. This is a very common issue. Therefore, there are numerous lenders that will help you refinance your debt. These companies provide you with longer terms and smaller instalments. However, this is only a precautionary measure and not the solution.

* **Communicate with your lender**

In case you feel that paying the instalment is going to be difficult in the next couple of months, talk to your lender. It is unwise to sit around and risk defaulting on your loan. Your lender may appreciate your proactiveness in managing your debt and help you by either reducing your monthly payments or extending your term.

* **Reschedule your debt**

If the amount of outgo of your company is the issue, you can always reschedule your finances. Your lender will revise your interest rates and the loan tenure will be increased. This means that the amount of monthly instalment will reduce and make things more manageable. However, this will still have a negative effect on your credit score, but it is better than defaulting on your loan.

* **Manage expenses and prioritize debt**

This could seem like simple advice, but is the building block of efficient financial planning. In the initial years of your business, ensure that there are only necessary expenses. Paying out your debt should be your first priority. There is no escape from monthly payments; therefore, ensure that all your other expenses are secondary to it. Further, borrow only what you need. A business loan incurs monthly payments and interests. This makes surplus debt liability to your business.

* **Seek legal assistance**

If push comes to shove and you see no way out of from defaulting on your loan, seek legal advice to know what rights you have and what provisions you can access in your situation.

**Conclusion**

When it comes to debt management, always ensure that you are never behind on your payment. Thereafter, if you still think you are going to default on your loan, doing nothing is not an option. You are responsible for the repayment of your debts in a way that secures your business.

**List of Keywords**

* business loan
* monthly instalments
* Default on a Business Loan
* loan default
* credit score
* secured loan
* unsecured loan
* financial planning
* finances and debts