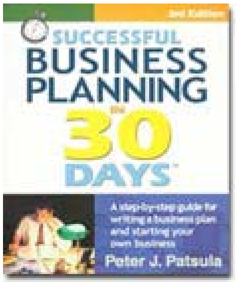
The ENTREPRENUER'S Guidebook Series™

Next Page

THANKS for selecting this guidebook! Many hours of painstaking work have gone into its creation. Send feedback or suggestions to www.patsulamedia.com. And check out our **highly rated planner / guide …** at bp30.com



Highly Rated
Amazon.com

It's one of the best of its kind.
- Alan Caruba
Bookview.com

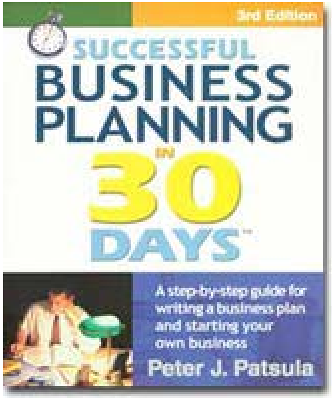
COPYRIGHT INFO

384 pages $21.95

Successful Business Planning in 30 Days™

A Step-by-Step Guide for Writing a Business Plan and Starting Your Own Business, **3rd Edition**

Purchase this book online at bp30.com or by calling toll-free **1-800-247-6553** (orders only, please have credit card ready).



ISBN 0967840236

Immersing you in the language of business to help you think like an entrepreneur!

INCLUDES:

- The **30 Day** Business Plan™
- The **One Day** Business Plan™
- 150 pages of **Time-Saving Worksheets** including 100 + sample passages to get you started fast and thinking in the right direction!
- A **15 page** sample business plan.
- **200** + motivational and fact quotes, 11 success stories, and 33 profit tips!

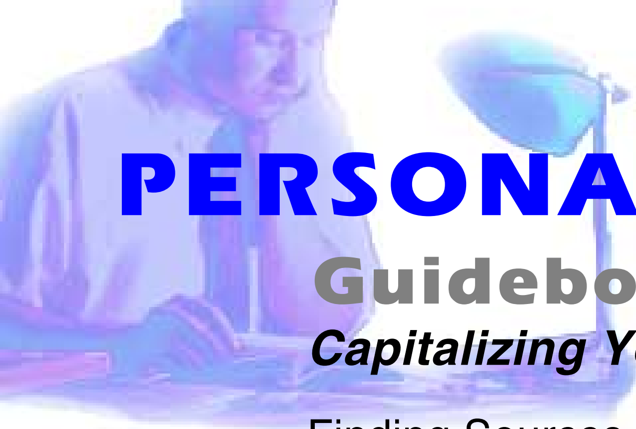
Praise from Readers and Critics

Five Star Reviews ★★★★★

Provides an important key to writing a business plan and starting your own business.
- **Midwest Book Review**, Oregon, WI
Amazon.com review

This is a must read for anyone before starting your own business.
- **Mike Milliken**, BN.com Review.

This book has helped me a great deal in thinking about my business
- **Jason Myers**, TX
Amazon.com review



PERSONAL PLANNING

Guidebook #81:

Capitalizing Your Operations

"I'm sorry . . . but do you have anything other than a wife and a cat to offer as collateral?"

CAPITALIZING YOUR OPERATIONS

MANY business ideas never blossom into mature full blown business operations due to one specific but fairly notable reason: lack of capital. It is many a would be entrepreneur's plight to scrounge up enough funds to meet not only basic start-up costs but also to cover operating costs needed to keep the business going long enough to gain a market share and establish itself.

To make matters worse, banks and investors typically want nothing to do with a new business unless its owners can personally guarantee their loan with collateral of equal or greater value. For some reason, an "I'll pay you back as soon as I can," along with a "cross my heart and hope to die" is not good enough for them.

FINDING SOURCES OF CAPITAL

THERE ARE four basic types of capital:

- cash capital (personal financing)
- credit capital (vendor financing)
- debt financed capital
- equity financed capital

Cash Capital – Cash capital is capital that you have to pay no interest on and you have ready access to. It is derived from personal savings, cashed in equity or borrowing from future cash contracts. Using cash capital is certainly the easiest, if not the best way to finance your business

A bank is a place that will lend you money if you can prove that you don't need it.
BOB HOPE

Credit Capital – Credit capital can be obtained from suppliers or credit card companies who give you a grace period before payment is due or interest charged. Many suppliers, if convinced of the soundness of your venture, will strongly consider granting you credit in their own efforts to find new customers and expand their business. Credit capital is often overlooked as a means of financing a start-up.

NOTE Also called *trade credit* or *vendor financing*.

Debt Financing – Debt financing is a direct obligation to pay interest to someone (an investor or lender), in exchange for having lent you the money. An important feature of debt financing is the interest rate you will be charged.

PROS of Debt Financing – The biggest advantage of debt financing is that it allows you, as the business owner, to retain, for the most part, control of your company. You're therefore entitled to all company profits and have ultimate decision-making authority. Your debt is limited to the loan repayment period. After you have repaid the borrowed money, the lender has no further claim on your business.

CONS of Debt Financing – The biggest disadvantage of debt financing is having to make those pesky monthly loan payments. When starting a business, cash may be scarce and expenses higher than estimated. Regardless, the lender will still expect to be paid regularly. If you miss a payment or are late, the lender may impose severe penalties, such as additional fees, a poorer credit rating or the possibility of calling the loan due.

Banks are here to help the people who want to come up in the world.
DAVID ROCKEFELLER
Investment Banker

Equity Financing – Equity financing involves no direct obligation to repay any funds. It does, however, involve selling a partial interest in your company. Which means, in effect, that all new equity investors will become new business partners. Not only will they share in your profits but also will have a degree of control over how you business is run.

PROS of Equity Financing – There is no debt, and no monthly loan payments. You also will likely have more freedom for trying new ideas with a potential equity investor than with a debt investor. Since it is in an equity investor's best interest for your business to grow and expand, he or she will be more likely to consider sound business ideas than a debt investor. Bankers are more concerned with getting paid every month. Also, equity investors, with their genuine interest in your success, can be a good source of advice and contacts for your business.

The biggest drawback of equity financing, besides the fact that you will have to share your profits with others, is the loss of control over your business.

CONS of Equity Financing – The biggest drawback of equity financing, besides the fact that you will have to share your profits with others, is the loss of control over your business. Quite often, your equity investors will not agree with your short-term or long-term plans, and since you have given them a share in the ownership of your business, you will have to seriously consider their point of view.

Another drawback of equity financing is that it tends to be very complicated and invariably will require the advice of attorneys and accountants. You will have to prepare and file a considerable amount of paper work. You will also have to wade your way through a great deal of red tape.

50 Sources of Captial

Below is a list of **50** cash, credit, debt financed, and equity financed sources of capital:

Cash Capital

1. **Advance Payments from Contracts –** Try and get you first big contract paid for in advance.

2. **Cash Value of Life Insurance –** Although it's not wise to cash in your life

insurance polices, if you have no other choice its worth considering (you also may be able to use it as collateral for a loan).

3. **Conditional Sales Agreements –** Try and get conditional sales agreements which may offer you some cash in advance.

4. **Contra Bartering –** Offer to exchange your service or product for services or products from other companies.

5. **Licensing or Assigning Exclusive Rights –** Offer special exclusive rights or licenses to copyrights or patents you may have to other entrepreneurs (see Guidebook #75).

6. **Modifying Personal Lifestyle –** By modifying your personal lifestyle, you can reduce your living expenses and thus increase the amount of money you can put into your business. As you will find out in Guidebook #82, reducing expenses (operating on a low overhead) is one of the best profit building strategies.

Seventy-five percent of small businesses start with their own capital and loans from family and friends. ***FUNFACT***

7. **Money Owed to You –** Collect from those that owe you money.

8. **Pension Plans –** As a last resort you may want to cash in some of your RRSPs, IRAs, annuities or other pension funds. Although this isn't advisable.

9. **Personal Savings & Checking Accounts –** One of the biggest advantages of using personal savings to fund your business is your easy access to

those funds. There are no loan applications to complete, no lenders to visit, no paperwork to prepare and no interest payments to make.

NOTE You must invest some of your own money, otherwise you will have difficulty convincing others that your idea is sound.

10. **Home Equity –** Many entrepreneurs finance their businesses by taking out a second mortgage.

11. **Renting Out Part of Your Home or Garage –** If you have a basement or garage that can be converted into a self-contained apartment, consider renting it out.

Combining personal savings with external sources of debt and equity will permit you to benefit from the effects of leverage i.e., using other people's money to earn a profit for yourself.
SUPERTIP

12. **The Small Business Innovation Research (SBIR) Program –** This Program is designed to stimulate technological innovation in the United States by providing qualified small businesses with opportunities to propose innovate concepts that meet the research and development needs of the federal government. The SBIR program offers an excellent opportunity for the research-oriented, existing enterprise, but it has little relevance for the average inventor of consumer goods.

    Do not expect the SBIR program to fund your idea unless **1)** you invention fits a specific government need, and **2)** you have in place an organization capable of carrying the project through to completion. It is very rare for individuals to obtain SBIR funding.

Eleven federal agencies presently participate: Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services and Transportation, Environmental Protection Agency, National Aeronautics and Space Administration, National Science Foundation and the National Regulatory Commission.

Almost all businesses need outside funds, and yours probably will not be an exception to the rule. ***SUPERTIP***

The SBIR program has three phases:

Phases 1 – Evaluate the scientific/technical merit and feasibility of an idea. The government makes competitive awards of up to $50,000 of for a period that usually does not exceed six months.

Phase II – Pursues the technological development of the idea studied in Phase I. The government offers up to $500,000 for a development period that normally cannot exceed tow years. Only Phase I awards are considered for Phase II awards.

Phase III – Commercialize the product developed in Phase II. The commercialization phase requires the use of private or non-SBIR funding.

13. **Selling Unnecessary Personal Assets –** Any personal assets you have whether fixed or liquid, especially unnecessary possessions like a sec-

ond car or motor home, can be used to finance your business. Other assets you may want to liquidate include: savings bonds, stocks and bonds, mutual funds, real estate, antique furniture, art and jewelry.

NOTE It is also possible to sell your own company assets to a commercial leasing company and then lease them back through them.

Where Do Entrepreneurs Get Start-up & Operating Capital?

ACCORDING TO A SURVEY conducted by INC. Magazine, 56 percent of all entrepreneurs begin with their own seed money, 41 percent receive bank loans, and only 2 percent obtain venture capital. Of those who use their own resources, 40 percent get loans by mortgaging their personal assets, primarily real estate. Another source found that nearly 75 percent of all new entrepreneurs start with some of their own saved-up money of which twenty-three percent use only their personal funds. In a nutshell, most companies start with little or no borrowed capital from lending institutions or government agencies. For most companies, the marketing need is defined enough that they can usually fund themselves through the stock market, the customer, or through vendor financing in addition to using their own savings.

Credit Capital

14. Business Credit Cards – Although it is generally recommended that businesses use a checking account to pay expenses, sometimes credit cards can be used to conserve cash.

NOTE Using your own personal credit card for business purposes is possible. Although it isn't recommended unless you are desperate, for it can create difficult accounting problems as well as charge a high rate of interest.

15. **Letter of Credit –** A request from an exporter to a bank for a loan on a business transaction is a request for a letter of credit. For most exporters, sellers are far away and may be operating under different legal, political and business practices. With a letter of credit issued by a reputable International bank, both parties are assured and protected – goods will be properly shipped an received, and payment will be rendered as promised.

A request from an exporter to a bank for a loan on a business transaction is a request for a letter of credit.

A letter of credit can be considered a guarantee issued by a bank on behalf of its client, usually irrevocable, to a supplier guaranteeing payment if the merchandise ordered is shipped in accordance with the terms and conditions specified. When the bank guarantees payment of a debt, it is substituting its own credit for that of the applicant; the bank and will pay for the transaction if the applicant fails to make the agreed payment. The seller has little risk in such transaction. The bank charges a fee or interest for the generally short term of the transaction.

16. SBA's Export Revolving Line of Credit – To assist small businesses in exporting their products and services abroad, the Small Business Administration has established the ERLC program, through which the SBA can guarantee up to $750,000 or 85 percent of a loan. The maximum guarantee for loans up to $150,000 is 90 percent. An applicant may have other outstanding loans as long as the total does not exceed $750,000. The maximum maturity of the loan cannot exceed 18 months. Collateral will be required, including personal guarantees, accounts receivable, inventory, assignments of contract proceeds, and bank letters of credit.

When a vendor allows you to buy a product and to delay paying for it, this is known as trade or vendor credit.

17. Trade Credit (Vendor Financing) – Establishing credit accounts with suppliers is a normal form of financing employed by many business enterprises. It means that suppliers ship goods and supplies to your business, bill you, and give you time to pay the invoice (usually 30, 60, or 90 days).

Although, by using trade credit, there may be a hidden cost for flexible credit terms in the form of slightly higher prices, to your advantage you will be able to purchase supplies and equipment directly from a vendor and spread your payments over several months or years. In fact, often it is possible to make no or a minimal down payment and to avoid interest charges completely. Even suppliers who will not extend credit in the beginning of your relationship may be very willing to do so after you have placed several orders.

Vendors offer this service to help make their products more attractive and to induce you to buy from them rather than elsewhere. Offering easy credit terms encourages sales.

Vendor financing is not desirable if you are being charged substantially more for the same product you can purchase elsewhere more cheaply with cash.
SUPERTIP

NOTE For a typical, non-financial business, accounts payable created using trade credit, are the largest component of current liabilities, usually about 40 percent of total, short-term debt. The percentage is often higher for smaller businesses due to the unavailability of other sources of financing.

Debt Financing

18. Accounts Receivable Financing – Accounts receivable financing can take the form of pledging receivables as collateral to obtain a short-term loan (if the accounts receivable becomes uncollected, the borrower is responsible for repaying the loan and incurring the resulting loss).

NOTE This is a method of obtain secured loans for business which lack other collateral for short-term funds.

19. Commercial Banks – When resources are exhausted or lacking, many entrepreneurs go to a bank and talk to a loan officer. There are over 15,000 commercial banks in the United States. They are the major source of business capital and issue about 85 percent of all the loans granted to operating small businesses.

However, these banks are in the business of lending money to well-managed, creditworthy enterprises. In other words, the business operations they serve must generate sufficient cash flow to assure the loan officers of its capability to make stipulated payments. As well, the collateral put up has to have a greater value than the amount borrowed, liquidity and a stable economic life. Personal guarantees are invariably required.

It is dangerous to have too much credit capital. One day it has to be paid back in the full amount.
SUPERTIP

NOTE Keep in mind that asking a bank for a loan is essentially asking it to become a partner, for a specified period of time and guaranteeing it, as a partner, a predetermined rate of earnings (see Guidebook #89 for information on finding a good banker).

20. **Commercial Finance Companies –** By offering inventories, receivables, and similar holdings as collateral, you may be able to borrow short-term funds from a commercial finance company. Commercial finance companies are similar to consumer finance companies (e.g., Uncle Ed's Loan Shark House), but concentrate on business loans rather than consumer loans. They can be a useful partner if you manufacture products or

act as a wholesaler.

Like consumer finance companies, commercial finance companies charge higher rates of interest than banks. However, to their advantage they are usually more willing than banks to approve your loan requests.

Small community banks with two or three branches may operate quite differently form large commercial banks with hundreds of loan offices.

Commercial finance companies will often require your debt be collateralized, meaning that if purchase a cash register with the funds you have borrowed, they will have a direct claim on your cash register. In fact, if you can't make your monthly payments, a couple of big guys in blue suits may waltz into your store and take back your cash register to sell it and recover their invesment.

21. **Community Banks –** Community banks or savings banks are more experienced in dealing with consumer loans, such as home mortgages and automobile loans.

NOTE Small community banks with two or three branches may operate quite differently form large commercial banks with hundreds of loan offices.

22. **Consumer Finance Companies –** Consumer finance companies make small personal loans secured by collateral.

Loans from this source will usually not exceed several thousand dollars. Unlike banks, consumer finance companies do not accept deposits. They operate under the jurisdiction of each state's small loan regulations. They charge higher interest rates and processing fees than banks and credit unions but can be more flexible about approving requests. In some cases, the interest rate you will be charged will be the highest allowed by law for your state. If you can't repay your debt, a couple of big guys in leather jackets may waltz into your store and sieze whatever you used the funds to purchase.

Credit unions are financial institutions developed by the members or employees of a company, religious group, labor union, division of the government or other group.

NOTE Consumer finance companies can be found in the yellow pages under loans.

23. Credit Unions – Credit unions are financial institutions developed by the members or employees of a company, religious group, labor union, division of the government or other group. Their overall goal is to service their members, not turn a profit. Because of this, their interest rates and other terms are usually more favorable than those offered by a bank. There are about 9000 credit unions in the U.S. with assets from five to fifty million. Altogether, credit unions of assets totaling more than 200 billion. Credit unions are regulated by the National Credit Union Administration.

NOTE The company for which your or another family member works may have a credit union. If you decide to start your business while you are still working for a large company you may be able to borrow some of the capital you will need from the credit union. While the amount you will be able to borrow from a credit union may note large, credit union interest rates are often lower than the rates charged by other lenders.

24. **Equipment Financing –** Borrow from a bank, finance or acceptance company to purchase machinery or equipment, and then use that equipment as collateral for another loan.

25. **Ethnic Community Organizations –** Many ethnic communities set up special funds to help other members of the same ethnicity start a business.

Factoring companies are a special type of commercial financing company involved specifically in purchasing outright the accounts receivable of their clients.

26. **Factoring Companies –** Factoring companies are a special type of commercial financing company involved specifically in purchasing outright the accounts receivable of clients. It usually means a continuous agreement whereby the factor is responsible for granting credit to its client's business customers, performing the accounts receivable bookkeeping and collecting the accounts.

More simple put, factor companies purchase your accounts receivable at a discount, thereby freeing cash for you sooner than if you had to collect the money yourself. You transfer title of your accounts receivable to the factor company in exchange for a cash payment.

To do business with a factor, your business volume should be over $250,000.

Before buying your A/Rs, the factor will check their quality. If they are willing to buy them, they will usually advance up to 85% of approved A/Rs pending collection. The original purchaser will then be notified of the sale of the receivable and is required to make payments directly to the factor.

Factors provide two types of financing alternatives: recourse factoring and non recourse factoring.

- *Recourse Factoring –* In recourse factoring, you retain the risk of collecting all the debts owed to you. The factor company purchases your receivable and advances you cash while the accounts are being collected. However, if your customers do not pay, you will be held responsible for repayment to the factor company.

Factoring companies are not appropriate as a means of seed capital to start a business because they require that you have accounts receivable to sell. ***POWERPOINT***

- *Nonrecourse Factoring –* In nonrecourse factoring, you sell all rights and obligations concerning your accounts receivable. The factor company purchases your receivable and collects the debts owed. If a customer does not pay, you will be under no obligation to the factor company.

NOTE Factor companies often advertise in the business sections of newspaper. Usually the advertisement will say “We buy accounts receivable.” Make sure you work with a reputable company that will not alienate your customers by harassing them for payments.

Government bureaucracy is often slow, cumbersome and involves much red tape. Under no circumstances can you expect action that will help you meet next week’s payroll. ***SUPERTIP***

27. Floor Financing – Usually used by car dealers, piano, furniture and large appliance dealer to finance their floor stock. The lender maintains legal ownership of the floor items while the retailer displays them for sale. Similar to selling on consignment.

28. Giving Your Corporation a Personal Loan – A good strategy when starting a corporation is to invest in the company by means of shareholder’s loan. This allows you to take this money out of the company without tax. Three additional points to consider if you give your corporation a loan are as follows:

- It is easier to repay a loan than sell shares back to the company or to other investors
- interest on the loan paid to you by the company is tax deductible by the company
- lenders consider shareholder’s loans as equity as long as they are left in the company

NOTE Keep in mind that the only method of withdrawing your investment from a limited company is by paying yourself wages (which are taxable) or by dividends (which are also taxable).

29. Government Loans – There are numerous sources of financial support available to small businesses from the federal government, most state governments and many county and city governments. These sources generally guarantee loans within specific limits to businesses engaged in designated lines of endeavor, support research and development, provide low-interest loans, and in some states have direct investment similar to a venture capital fund.

Occasionally, SBA will test new loan products or services different loan programs may include reduced paperwork, shortened approval periods, or smaller loan amounts. ***FUNFACT***

However, dealing with the government, at any level, is often time-consuming and frustrating. Extensive paperwork is almost always required, and when you begin you have no assurance of a successful conclusion. To make matters more frustrating polices and programs change which each new government.

- *Economic Development Commission (EDC) –* Part of the Department of Commerce (DOC), The Economic Development Commission, lends to new and existing businesses in an effort to create new jobs in economically deprived regions. There are a number of specific conditions that must be met in borrowing through the EDC, including location. Contact the EDC through the DOC.

- *SBA Loan Guarantee Program* – The SBA Loan Guarantee Program provides financing in cases in which banks feel uncomfortable with the risk by allowing banks to recover their money from the SBA if the borrower defaults. The program is designed to promote small business formation and growth by guaranteeing long-term loan to qualified firms that cannot obtain financing on reasonable terms through normal lending channels. Funds are available to establish a new business or enlarge and existing business, and may be used to acquire machinery or equipment, inventory or for working capital.

Terms for SBA loans are usually better than those for regular bank loans with interest rates not exceeding 2. 75 percent more than the prime lending rate.

SBA guarantees up to 90 percent on loans of $155,000 and less and up to 80 percent on loans to the maximum of $750,000. Loans vary in size from $20,000 to $750,000 with most in the $150,000 range.

Terms for the loan are usually better than those for regular bank loans with interest rates not exceeding 2. 75 percent more than the prime lending rate, maturities available up to 10 years for working capital and 25 years for fixed assets, and required equity positions less.

Because the life of an SBA loan can

be longer than that of conventional bank loans, this results in a lower monthly cash payment, which can enhance the cash flow of the firm during the early years of the loan.

However, keep in mind that this loan is intended for use by companies unable to obtain loans through conventional channels.

To get an SBA loan, first apply for a direct loan. If the direct loan is declined, ask the bank to: a) give you a loan under SBA's Guaranty Loan Plan, or b) participate with SBA in a loan (banks unwilling to lend to small businesses because they are unable to cover the entire loan with personal guarantees are frequently willing to lend with a partial SBA guarantee).

The equity position for an SBA loan can be 30 percent compared to the 40 to 50 percent required by most banks (the SBA percentage can vary depending on the type of business and your past credit history).

POWERPOINT

If the bank is interested, ask the banker to discuss your application with the SBA. In most cases, SBA deals directly with the bank on the above two types of loans. If neither the guaranty nor the participation loan is available to you, you can still visit or write your nearest SBA office. In all cases above, you must have the necessary financial information with you to state your case and needs i.e., a good business plan.

NOTE There is a 2-percent fee for the guarantee, which is sometimes reduced to 1 percent for loans under $450,000. This fee is paid from proceeds when the loan is allocated. The upper limit for an SBA loan guarantee is $750,000. There is no lower limit, however most banks prefer to work with amounts over $10,000.

- *SBIC & S-SBIC Loans –* SBICs (Small Business Investment Corporation) and S-SBICs (Specialized Small Business Investment Companies) are licensed to provide financial services to small business in the form of equity & venture financing for modernization, expansion, and the like. They are especially interested in purchasing stock in promising small corporations and seek to become involved in actual business operations by providing management direction. SBICs and S-SBICs are licensed by the SBA and operate under its guidelines. They are privately owned organizations, chartered by the state in which the operate.

SBICs and S-SBICs are especially interested in purchasing stock in promising small corporations and seek to become involved in actual business operations by providing management direction.

NOTE You can obtain the *Directory of Small Business Investment Companies* by visiting the SBA regional or district office nearest you.

- *Other Government Agencies –* A government agency may be interested in financing new businesses that will have a direct impact on the agency or the client population it services. If your business produces a product or service you feel would be of interest to a government agency, contact the agency directly and request information and applications for grants and other possible business development resources that agency may control. It may be helpful to investigate some or all of the following general sources of assistance available through the government.

If your business produces a product or service you feel would be of interest to a government agency, contact the agency directly and request information and applications for grants and other possible business development resources that agency may control.

30. Financing with Accruals – Firms generally pay employees at regular intervals rather than as work is performed. Likewise, estimated business income taxes, sales taxes, and various deductions withheld from employee payroll, are also paid periodically. The business thus has the use of such funds from the times taxes are collected or work is performed until payments are made. Since there is no explicit interest expense involved, the firm in essence, receives a form of "free" credit.

However, since the payment of accruals is dependent upon contractual agreements or statues, business owners have little control over this type of "debt." Using accruals as a form of financing is thus not a recommended business practice, although it could save you in a pinch.

NOTE It is wiser for a business to take advantage of its accruals by investing them, rather then using them as a controllable means of financing.

31. **Home Equity Loans –** These types of loans can be made for a variety of purposes from non-commercial banks, including business-oriented situations. The borrower pledges an asset such as their house as collateral for the loan.

32. **Installment Financing –** Pay for equipment, supplies and inventory by installments.

Insurance companies are a possible source of financing for your business because they make commercial loans as a means of investing unused portions of their income.

33. **Insurance Companies –** Insurance companies are a possible source of financing for your business. Often they make commercial loans as a means of investing unused portions of their income. Generally, insurance companies make term loans and mortgage loans.

    If you borrow from an insurance company, you can expect terms and interest rates similar to those available from a commercial bank though in some cases higher. To their advantage, insurance companies can provide large amounts of capital at market interest rates, but you must have assets sufficient to cover the debt (and usually 20-30 percent extra).

34. **Inventory Financing –** The existence of inventories maybe enough reason for a financial institution to pro-

vide an unsecured loan to a small business. Other firms, with unestablished credit history, may use inventories as collateral to obtain a loan in one of the following three forms:

- *The Inventory Blanket Lien* – The inventory blanket lien gives the lender claim against part or all of the borrower's inventories, although the borrower is free to continue to use and sell the inventories.
- *A Trust Receipt* – A trust receipt can be used to certify that certain goods are held in trust for the lender and are separate from other portions of the inventory. If any of the trust goods are sold, the borrower is required to immediately forward the proceeds to the lender.

With the issuance of a trust receipt on specific goods, a lender must regularly check the borrower's inventory to ensure compliance with the agreement.

NOTE With the issuance of a trust receipt on specific goods, a lender must regularly check the borrower's inventory to ensure compliance with the agreement.

- *A Warehouse Receipt* – Similar to a trust receipt, a warehouse receipt gives the lender claim to the borrower's inventory. The goods, however, are kept on a separate part of the borrower's premises, or at a field warehouse with an independent third party warehousing company, acting as the supervising agent.

NOTE Generally an efficient warehousing arrangement requires at least $1 million dollars of inventories. The fixed costs of warehousing arrangements are relatively high.

35. Leasing Equipment – A leasing company rents various types of equipment to businesses and individuals on a long-term basis. By renting rather than buying the equipment your business will need, you will be able to avoid many capital expenditures associated with the purchase of equipment.

By renting rather than buying the equipment your business will need, you will be able to avoid many capital expenditures associated with the purchase of equipment.

Generally, leasing companies require a down payment or several months prepaid rent. Some however, may allow you to lease equipment without requiring any prepayment. The small amount of cash needed to secure the use of equipment for your business makes leasing very attractive to many business owners.

NOTE An advantage provided by leasing is that you will need little or not cash to secure equipment and you will be able to upgrade your equipment more easily than if you purchases it. If your industry experiences rapid changes in technology, leasing may help you to avoid the expense of purchasing quickly outdated equipment.

36. Leasing Land & Buildings – When you lease or rent property, ownership rests in the hands of the bank or leasing company, while the business has the actual use of it. Leasing or renting helps reduce your start-up capital needs and can help you solve cash flow problems.

NOTE A new business should rent land and lease equipment to avoid fixed capital outlays to the greatest extent possible. Many businesses fail because they simply run out of money having purchased items they could have financed, thereby leaving themselves short of operating funds.

Family members can help finance you business by giving you a loan or by buying shares in your company.

37. Loans from Family, Friends & Relatives – Family members can help finance you business by giving you a loan or by buying shares in your company. The terms of repayment are likely to be more flexible than those of strangers. However, keep the relationship as formal as possible. It's a good idea to prepare a formal agreement when a friend or relative is willing to invest money in your business. This will make the relationship professional and will help to avoid future misunderstandings about how much was borrowed or when it should be repaid.

NOTE One problem with getting a loan from a friend or relative is that they may feel their investment entitles them to routinely tell you how your business should be run.

38. Local & State Loan Programs – State financial programs are available to small business owners who need financing. Most programs are justified by the economic development and the jobs created within the state by the business. At times these programs can take a second mortgage position compared to banks or other sources of debt and can charge lower interest rates. Many state programs have special programs for women, minorities, or manufacturing businesses. Listed below, are several programs previously offered by the state of New York:

- *Corporation of Renovation Development –* The CID program is administered by the New York State Science and Technology Foundation and provides debt and equity capital to new technology based businesses with fewer that 100 employees. CID operates in a way similar to a private venture capital fund but is willing to take greater risks.

To contract new debts is not the way to pay old ones.
GEORGE WASHINGTON

- *Energy Investment Loan Program –* This is a state loan subsidy at very low interest rates in amounts up to 1 million. The objective of this program is to conserve energy in businesses, housing and farms.
- *Job Development Authority Direct Loan Program –* This program provides loans of up to 40 percent of the project cost for new and small businesses for acquisition or rehabilitation of plants, and for machinery and equipment. Priority is given to projects that contribute to revitalization of distressed areas.
- *Job Development Authority Rural Development Loan Fund –* This program provides flexible, low cost

loans to small businesses located in rural areas and small communities with populations of less than 25,000.

- *Urban Development Corporation Minority Revolving Loan Fund –*This fund is designed to provide low-cost financing to certified minority and women-owned businesses.

NOTE The financial aid and assistance programs of the various states in the U.S. are more diversed than the federal programs. Most are intended to create or maintain jobs within the state, to attract companies to move to the state or to keep companies from relocating out of the state.

The financial aid and assistance programs of states are more diverse than the federal programs.

39. **Minority Enterprise Small Business Investment Corporations (MESBIC) Loans –** The federal government encourages private enterprise by members of minority groups. MESBICs have been licensed to aid to small enterprises owned by minority-group members.

40. **Owner/Seller Financing –** This is where the owner of the business you are buying carries the loan.

Equity Financing

41. **Closed-end Investment Companies –** Similar to venture capital firms, closed-end investment companies are interested in purchasing the stock of your business. They are called "closed" because they have a fixed amount of money available to invest.

42. Corporate Capital Sources – In order to generate additional profits, corporations sometimes establish corporate venture capital firms. These firms differ from traditional venture capital firms is that they are not motivated purely by profit, at least not in the immediate sense. A corporate venture firm typically seeks access to new markets in addition to realizing a financial gain.

Associating your business with a corporate capital source can add credibility when you seek funds elsewhere.

Associating your business with a corporate capital source can add credibility when you seek funds elsewhere. The expertise of the corporation can also be useful in marketing, manufacturing, product development.

Corporate investment in your business will probably take one of several forms:

- *Complete Purchase –* Here, an outside corporation buys your business in its entirety, and you forfeit all rights and control.
- *Licensing Agreement –* As the business owner you retain control of your business but receive cash for work performed on contract. Sometimes entering into a licensing agreement means giving up the rights to products developed under this agreement.
- *Joint Venture –* You and an outside corporation create a partnership, typically one in which you run the business and the corporation provide

capital and business advice.

- *Partial Purchase –* An outside corporation purchases part of your business's stock.

NOTE A useful source of info on corporate capital suppliers is *Corporate Venturing News* published by Venture Economics, Inc., 16 Laurel Avenue, Wellesley Hills, MA 02181

It is possible to start some franchises with relatively little money and to obtain start-up financing directly from the company selling the franchise. If a direct loan is not possible, the seller of the franchise may be willing to cosign a loan with another lender.

SUPERTIP

43. Customers as a Source of Funds – In some industries, potential purchasers of your service may be interested in offering financial help as you start or expand your business. They are interested because an additional supplier provides them with another source for a product or service they need.

NOTE Beware of granting exclusive rights to your products, which may give the customer more control than you would like business operations and pricing. This type of arrangement will shrink the potential market tremendously.

44. Employee Stock Ownership Plans (ESOPs) – If your business has employees, it may be possible for you to sell stock in your business directly to them. In a sense your employees become your partners. That advantage of creating an ESOP rather than selling stock to outside investors is that your employees will have a vested interest in making your business successful.

Under this plan, employees purchase shares of stock and thereby gain an ownership interest in your business. Employees may also offer to take a reduction in salary or benefits in exchange for partial ownership in the company.

NOTE More information is available from the ESOP Association, 1100 17th Street, NW, Suite 1207, Washington, DC 20036.

45. Franchising – Offer franchises of your business to other entrepreneurs (see Guidebook #76). Let them worry about coming up with the necessary start-up capital.

Willy, I made the final payment on the mortgage today. We're free and clear . . . we're free . . . we're free.
LINDA
Speaking at the grave of Willy Loman in Arthur Miller's "Death of a Salesman"

46. Investment Clubs –In many communities, groups of business people form organizations to invest in new and existing businesses, usually on the local level. Here, private investors pool resource to make investments. Investment clubs are often informally structured.

47. Issuing Stock – If you organized your new firm into a corporation, you may be able to raise funds by selling some of your shares to others, making them shareholders, and thereby endowing them with part ownership of your business. Your charter (written by an underwriter) specifies the amount of shares your corporation is authorized to issue.

Generally, issuing stock is done by selling common or preferred shares. Preferred shares include certain privileges of the shareholder – for example, if the business fails, the shareholder is guaranteed a proportionate share of the remaining assets. Usually, though, only holders of common stock enjoy voting rights in the company.

The borrower is servant to the lender.
OLD TESTAMENT
Proverbs 22:7

However, issuing stock is a complicated and expensive procedure ($25,000 minimum). Furthermore, it imposes additional obligations upon your company – the purchasers of equity may increasingly become an important and annoying part in the management of the corporation.

If you are considering issuing stock to finance your operation, follow these three steps:

- *Step 1* – Determine from your analysis that your business will need more funds than you can provide.
- *Step 2* – Consider financing options and decide that you prefer to sell an interest in your company rather than borrow money.
- *Step 3* – Arrange to offer a sale of stock. This can be much more complicated than it sounds because you must comply with an array of legal and reporting requirements for the life

of your business.

NOTE Issuing stock is not always the most desirable method of raising money particularly for independent-minded entrepreneurs. It is usually advised instead to try debt financing before resorting to equity financing. Only preferred stock sold with a specific payback clause can be bought back and liquidated at the option of the entrepreneur.

When approaching any financial institution, you are effectively selling the merits of your business proposal. Thus, as in all sales, consider the needs of the other party when pitching your proposal. ***SUPERTIP***

48. Private Investment Limited Partnerships – Limited partner(s) who provide funding are not responsible for any debts your business incurs and will typically not play a role in managing the day-to-day operations. Private limited partnerships with 35 or fewer members are not required to register with the Securities and Exchange Commission. The typical investment is $20,000 or more per partner.

As the general partner, you are responsible for overseeing operations and for making decision that will have an impact on the business and its performance. The limited or passive partners provide you with funds and expect a substantial return on the investment. However, the return they will require may be less than that required by a venture capital firm.

49. Private Investors – Private investors could include: previous employers, previous co-workers; friends and neighbors; lawyers, accountants: stock brokers; and investment partners.

NOTE It is also possible to find investor by joining business organizations and clubs, where you may meet individuals with money available to invest. Your banker, attorneys and accountant may be useful sources of referrals.

Creditors have better memories than debtors.
JAMES HOWELL

50. Venture Capital – When private money or normal bank loans are unavailable, venture capital is often the only way to get a fast-track product or service off the ground – after all half a loaf is better than none. One of the most important advantages of dealing with a venture capitalist is that they have access to large amounts of money. Except for the very small funds, minimum investments are frequently in the $500,000 to $1 million range and often can go as high as $5 million or more. In addition, it is quite typical for this kind of venture investor to make second and third infusions of capital as the company grows (as well as provide invaluable experience into the investment banking industry once the company decides to go public).

Venture capitalists invest about one billion a year in various enterprises; mostly existing expanding businesses that are novel and interesting enough to promise high profit return and a fairly short-term buy out or the opportunity to go public. Emerging growth and high-technology companies are prime prospects for venture capital infusion.

However, venture capitalists are usually not interested in granting loans outright. They prefer to put additional capital into a growing business in exchange for part of the ownership. Invariably, the investors will want a major portion of your company's equity.

Emerging growth and high-technology companies are prime prospects for venture capital infusion.

It is also important to note that venture capitalists are not passive investors. They play an active role in the strategic planning phase of your business. They will also expect to be fully informed about operations, problems and whether your joint goals are being met.

To reach a venture capitalist, whether an individual, a small investment group, or a large insurance company, you must go through much the same procedures as for a bank loan – that is, prepare a meticulous business plan and show proof positive that projections are or at least appear to be valid. One should also consider that most venture capitalists have already been there. They play with money they can afford to lose. And although all are eager to put their excess financial resources to work, they seldom become involved with a new undertaking, unless they're convinced it will indeed be a winner.

- *What are Your Chances of Getting Money from a Venture Capital Firm?*

Consider the problem of presenting a business plan to the venture capital firm from which are seeking an investment. In a venture firm: four out of five plans will be reviewed and discarded in 10 to 15 minutes or less after a very cursory scan; of the remainder, four out of five will be read thoroughly, an hour or more and then discarded; the reminder may be of sufficient interest for the venture investors to either visit the company's facility or invite the management to their offices for further discussion; then four out of five of these will be turned down; now left with one out of a hundred business plans originally submitted, more will then be thrown out during serious discussion and negotiation of detailed terms; in the end at best one of hundreds or even thousands will result in an investment.

For more information see "Venture" and "INC." magazines which usually feature many ads from venture firms.

NOTE The process of getting capital from a venture fund can also be very slow. Venture funds are typical deluged by proposals and business plans form companies seeking money. Some people familiar with the venture industry suggest that a business plan submitted without a personal introduction has almost no chance of receiving attention.

- *What do Venture Capitalist look for in an Investment?* Venture capitalists are looking for two basic things when considering whether to invest in your business: **1)** high return – because venture capitalists are willing to take high risks by investing in an unproven business, they require high returns as well, perhaps 7 to 10 times their original investment within only 5 to 7 years; **2)** easy exit – venture capitalists like to be able to realize a profit by selling their interest in your business at some future point.

NOTE For more information see *Venture* and *INC.* magazines which contain ads from venture firms.

Directories are also available that list various funds, amounts of capital available, industry focus and addresses and telephone numbers of the managing general partners.

The mere existence of the venture capital industry has created a kind of entrepreneurial myth – that there are hundred of people out there standing in line waiting for the opportunity to give you money. Well that just ain't so. In fact, if you do find someone willing to part with their capital, you have to be willing to part with a significant part of your equity.
SUPERTIP

One such directory is *Pratt's Guide To Venture Capital Sources*, prepared by Venture Economic Inc., 16 Laurel Ave., Wellesely Hills. MA 02181. This book includes a 130-page introductory section about the venture capital industry and lists just about every venture capital fund in the U.S. and Canada.

Financing the Purchase of an Existing Business

BUYING AN EXISTING business may have certain benefits over starting a business from scratch. In many cases, the current owner will finance the sale of the business. Consider the following example, you read a newspaper advertisement of a small restaurant for sale in a good location. The owner is willing to sell his or her interest in the business for $15,000 if the buyer takes over existing business obligations e.g., space rental, employee wages etc. After visiting the restaurant and carefully analyzing the business potential, you decide you are interested in owning this business.

How can you pay for the business? Let's assume that you don't have $15,000. You have calculated that by using the money you've saved you can offer the owner $3,000. But this still leaves you $12,000 short. What are your alternatives?

1. Try to find a way to borrow the money.
2. Offer the owner less than the asking price, thereby reducing or eliminating the amount of cash needed.
3. Ask the owner to finance the $12,000 or help you find financing. An owner who needs to sell a business will be anxious to help you find a way to make the purchase possible.

Why is it being sold? Learn why the owner is selling the business. Make certain that the reasons do not spell disaster for you as the new owner. You may have nothing to worry about if the present owner is selling in order to retire. However, if he or she is selling because the business is not profitable due to few customers and/or poor location, you will need to realistically assess your ability to improve the situation.

Where to find businesses for sale? The classified section of your newspaper is a good source of information on businesses for sale. You may also want to contact a business broker who, like a real estate broker, sells businesses and properties for a commission.

WHAT BANKS & OTHER INVESTORS LOOK FOR WHEN YOU APPLY FOR CAPITAL

BANKS FAVOR emerging and developing businesses that have a proven track record and need additional capital for expansion, **NOT** start-up operations. The reason for this is simple: many start-up operations fail. Therefore, why should they take the risk? Investors on the other hand are a little bit more flexible. Yet they too will normally reject your application unless most of the following criteria is met:

Small debts are like small shot; they are rattling on every side, and can scarcely be escaped without a wound: great debts are like cannon; of loud noise, but little danger.
SAMUEL JOHNSON

Ability to Serve a Debt

If you are asking for a loan, first and foremost, banks and investors want to know how well you can service a debt – that is carry interest charges and eventually be able to repay the loan in full. They need reassurance and proof that interest payments will be covered by earnings and the principal covered by the liquidation of whatever it is the money is going to be used for. They also like to see that you have a sufficient surplus of funds to cover unexpected costs. A cash flow forecast and projected income statement will show this.

Adequate Owner Investment

Most proposals will be rejected flat-out unless the owner has risked a substantial amount of the businesses capital needs. Investors and banks rarely invest in companies where their owner(s) have nothing to lose. They want to know that you have a serious level of commitment to the success of your business and that you too are sharing the risk.

If you owe your bank a hundred pounds, you have a problem, but if you owe it a million it has. ***JOHN MAYNARD KEYNES***

NOTE How much personal funds does a banker want you to have invested? There is not fixed percentage for this equity contribution, but most lenders require at least 25 percent of the total amount needed to establish the business. The amount of equity required is also influenced by other credit factors, such as management experience and adequacy of collateral.

Attractive Return on Investment

Investors can obtain returns of up to and sometimes exceeding 10% with relatively safe investments in mortgages and bonds. Therefore, in order to invest in your enterprise, which probably carries a greater degree of risk than mortgages, your business must promise better financial returns. Investors must be convinced that the payoffs will be attractive. They are willing to take a high risk, but they also expect a high rate of return e.g., to double their money in two or three years.

NOTE Equity Investors are interested in the business's long-term success and future profitability. Legally, equity investors are more exposed to risk than are debt investors. If a business fails, equity investors stand to lose more money than debt investors, since creditors are typically paid before owners. Since equity investor are taking the greater risk, they expect to earn more on their investment than do debt investors.

Speak not of my debts, unless you mean to pay them.
GEORGE HERBERT

Collateral

Anything of value that is owned by your company or owed to you and contributes to the worth of your business is an asset and can be pledged as collateral for a loan, property, or equipment purchase. Even your accounts receivable can be used as collateral for loans, but usually not at their full value – expect a value around 75 percent. As well expect a bank or factor to take into consideration the age of each account. Any account more than 90 days overdue will usually not be accepted as collateral, or will be sharply discounted in value.

On the other hand, soft assets which include such intangibles as goodwill, patents, formulas, and capitalized research and development (R & D) are not always accepted as collateral; they are, in fact, thought to distort a business's value and are regarded by investors as a danger signal if given to high a value. To some bank examiners, assignation of a high R & D value flies a red flag over an entrepreneur's business plan.

A bank considers collateral the final alternative (last resort) for collecting money if payment are not made on loan principal.

NOTE Even if your company is incorporated, it is becoming more and more common for banks to have major shareholders sign personal liability agreements (i.e., request your house be used as collateral to protect them in the event your corporation goes bankrupt).

As kids, we all worked for the company in one way or another. I got to work behind the candy counter or run the popcorn stand when I was five years old. The business was part of life, and it was always included in the dinner conversation. We heard a lot about the debt it took to open new stores, and I worried about it. I remember confiding to my girlfriend one time – crying – and saying, "I don't know what we're going to do. My daddy owes so much money, and he won't quit opening stores.
ALICE WALTON
on father, Sam Walton

Endorsers, Co-makers, Guarantors – A borrower may ask another person to sign a note in order to augment his or her credit. This endorser is then liable for the note: if the borrower fails to pay, the bank expects the endorser to pay. Sometimes the endorser may also be asked to pledge assets.

A *co-maker* is an endorser who assumes and obligation jointly with the maker, or borrower. In this arrangement, the bank can collect directly from either maker or co-maker.

A *guarantor* is an endorser who guarantees the payment of a note if the borrower does not pay. Both private and government lenders often require guarantees from officers of corporation in order to assure continuity of effective management.

Reasons Banks Don't Like to Foreclose – When a bank forecloses on a failing business, it is often unable to recover the full amount the owner paid for the assets, because of depreciation and the nature of a force sale. As a result, foreclosure leaves the banker with assets worth less than the dollar valued indicated on your balance sheet. For these reasons, you an understand why it is easier to borrow money to buy fixed assets (such as inventory, equipment, buildings) than it is to borrow money for marketing expenses or general operating costs.

"The Uniform Commercial Code" establishes procedures whereby a bank can seize any collateral pledged in a loan agreement in case of default of the loan.

The Uniform Commercial Code – *The Uniform Commercial Code* establishes procedures whereby a bank can seize any collateral pledged in a loan agreement in case of default of the loan. The value of collateral is usually listed in the asset section of the balance sheet; its value should always equal or exceed the amount of the loan.

Types of Collateral – Below is a selection of various kinds of collateral banks and investors will look at:

Accounts Receivable – Many banks will lend money against your accounts receivable using a notification or non-notification plan. Under the notification plan, the credit customer is informed by the bank that the account has been assigned to them and is asked to make payments directly to the bank. Under a non-notification plan, your customers continue to pay you and when you receive the money you pay the bank.

Inventory – Merchandise and any other assets of a retail, wholesale or manufacturing business that can be liquidated if necessary can be used as collateral. Unless otherwise specified in the loan document, plant and equipment (e.g., computers, cash registers, manufacturing equipment, telephones and other fixtures) can also be included as inventory to be held as collateral.

Life Insurance – The cash value of a life insurance policy, can be assigned to a bank and used as collateral. In some cases, this is preferable to borrowing directly from the insurance company. A bank loan is generally easier to obtain and often carries a lower interest rate.

If you buy expensive equipment, such as a cash register or a delivery truck, you may be able to get a loan using the equipment as collateral.

Newly Purchased Equipment – If you've recently purchased an expensive piece of equipment, such as a cash register or a delivery truck, you may be able to get a loan using the equipment as collateral (this kind of loan is also called a *Chattel Mortgage*). The bank will want to assess the present and future market value of the equipment and make sure it is adequately insured.

Real Estate – Real Estate collateral is usually used to secure long-term loans. In evaluating real estate al collateral, the bank will consider your equity, the market and foreclosure value of the property, and its insurance coverage.

Savings Accounts and Certificates of Deposit – It is possible to get a loan by assigning a savings account to the bank. If you assign an account at another bank as collateral, they get the passbook. The lending bank will also ask the other bank to show in its records that the account is being held as collateral (so you can't take out the money).

It is possible to get a loan by assigning a savings accounts to the bank.

Stocks and Bonds – Marketable stocks and bonds can be used as collateral. Banks will usually lend 75 percent or less on the value of high-grade stocks and up to 90 percent on government securities. The limit leaves a margin of protection for the banks if the stocks or bond declines in value. In fact, if the market value of the collateral falls below a certain level (outlined in the loan agreement), the bank may ask for a partial payment of the loan or additional collateral.

Trust Receipts for Seria Numbered Floor Planning Merchandise – Expensive merchandise that needs to be displayed to be sold, such as cars, boats, appliances, TVs, etc. may be a problem for small companies who can't afford to buy these products outright. One way to secure a loan for these products is by using a trust receipt. A trust receipt can only be used for serial numbered merchandise. It acknowledges receipt of a product, shows agreement to keep the merchandise in trust for the bank, and verifies the promise to pay the bank once the product is sold.

Warehouse Receipts – A bank may take inventory as collateral by lending money on a warehouse receipt. The typical loan is a percentage of the cost of the merchandise. A warehouse receipt shows that the inventory has either been placed in a public warehouse or has been left on your premises under the control of one of your employees who is bonded. Such loans are generally made on merchandise that can be readily marketed.

Bankers and investors like to think your company will be around for a while.

Company Stability

Bankers and investors like to think your company will be around for a while. They prefer public companies, that is corporations that issue stock purchasable on the stock market and have a life of their own. The reason for this is that public companies provide excellent liquidity and the greatest opportunity for obtaining equity capital since their shares can be sold to anyone. To determine your overall stability, bankers and investors will also look at your:

- company profits
- dividend payments
- equity
    - retained earnings

Equity Position

Bankers will review the current and projected equity position of a business. Their most important concern is not so much the dollar amount but the ratio of equity to assets or debt. A growing business should show an equity position of 30 to 50 percent in relation to total assets; i.e., the owners owns outright 30 to 50 percent of the company.

To obtain additional money for growth,

this equity position should be brought again into balance. This means that to maintain an equity position of 30 to 50 percent, additional equity may need to be brought into the company, before a bank will consider granting you an additional loan.

For example suppose your company's total assets are $200,000; total debt, $140,000; and owner' equity, $60,000. The equity-to-assets ratio is 30 percent. For this business to grow to an asset level of $400,000 the owner needs to provide an additional $60,000 of equity and then borrow another $140,000 debt.

Financial ratios are used by bankers and investors to determine the relative health of a business.

Financial Ratios

The relationships between amounts of invested capital, levels of sales, various cost categories, inventory turnover, and many other items, form what bankers and investors like to refer to as "Financial Ratios." Financial ratios are used by bankers and investors to determine the relative health of a business. As well, they can be used by management to provide valuable checkpoints allowing you to better control certain aspects of your business before it's too late to make adjustments.

The basic data for ratio analysis is contained in your companies *Balance Sheet* and *Income Statement*.

NOTE In the reference section of your local library are publications such as *The Almanac of Business* and *Industrial Financial Ratios*, which is a source of ratios that can be used to compare your performance with that of other, similar businesses. Standard industry ratios are also reported in *Dun & Bradstreet's Key Business Ratios*, P.O. Box 3224, Church Street Station New York, NY 10008. The significance of these ratios, the methods for calculating them, and industry averages are available through *Robert Morris Associates*.

Cost of Sales to Total Inventory – This ratio is used to assess how well your company has used the resources at its command. It is calculated by dividing the total cost of sales by total inventory.

Current Assets to Current Liabilities – This ratio is used to assess your companies solvency i.e., its ability to pay off debts promptly. A high current ratio is looked upon favorably and means that your company has more than enough cash on hand – and short-term assets such as inventory that can be quickly converted into cash – to meet all debts falling due within a year's time. As a rule, this ratio should be two to one. It is calculated by dividing the business's current assets by its current liability.

Net Income to Total Sales – This ratio, also called the Profit Margin ratio, is used to determine how profitable your company is. It is calculated by dividing your net income by your total sales. In this case, the larger the ratio, the better.

Net Sales to Tangible Net Worth – This ratio shows how actively invested

I don't have any experience in running up a $4 trillion debt.
H. ROSS PEROT
After President Bush's stress on experience on the 1992 presidential election debates

capital is being put to work by indicating its turnover during a period. It is calculated by dividing Net sales by tangible net worth (equity) to arrive at the number of times the invested capital is turned over in a period.

NOTE Tangible Net Worth (equity) is the true worth of the business (assets minus liabilities) minus intangible items in the assets such as good will or incorporation costs.

Profits to Tangible Net Worth – This ratio is a measure of return on investment and is considered one of the best criteria for profitability. It is calculated by dividing Net profits (after taxes) by tangible net worth (equity) to arrive at a percentage figure.

The most attractive type of personal collateral form the lender's point of view is real estate, marketable securities and cash value of life insurance. ***SUPERTIP***

Quick or Acid-test Ratio – This ratio calculated by dividing your companies current assets less inventory, by the amount of current liabilities.

NOTE The quick ratios measure liquidity and reveals whether the firm can meets its maturing obligations.

Return On Assets – This ratio is similar in function to the Profits to Tangible Net Worth ratio and is calculated by dividing your companies net income by total assets.

Sales to Fixed Assets – This ratio shows what sales are generated by each dollar invested in plant and equipment. It is calculated by dividing your companies total sales by total assets. For example if your sales was $400,000 and your company assets were $150,000, your sales to fixed asset ratio would be 2.76. This means that $2.76 of revenue was generated by $1 of assets.

Sales to Inventory – This ratio gives the average turnover of inventory for your company and is useful for comparing your company's performance with others within the industry. It is calculated by dividing annual sales by current inventory. For example if your annual sales was $400,000 and your current inventory was $100,000, your sales to inventory ratio would be 4. This means that you inventory turnovers four times each year.

For example if your annual sales was $400,000 and your current inventory was $100,000, your sales to inventory ratio would be 4. This means that you inventory turnovers four times each year.

Sales to Receivables – This ratio is used to find the number of days money is tied up in receivables and thus determines the average collection period for your company. It will tell you (and your banker) how much money you need to continue in business (e.g., how much it will cost to run your business for the amount of days your accounts receivable are tied up), and thus how much money you need to have on hand-or to borrow.

As a general rule, the greater your accounts receivable (what customers owe) the more capitalization you will need to tide your business over until those accounts are paid. Consequently, you may wish to charge interest on accounts that go beyond a certain deadline, say longer than 30 days.

This ratio is calculated by dividing accounts receivable by daily sales. For example if your annual sales were $400,000 of which $100,000 were accounts receivable, and your business was open for 300 days thus making your average daily sales $1,333, then your sales to accounts receivable ratio would be 75 days.

Times Interest Earned Ratio – This ratio measures the long-term solvency of your company. It is calculated by dividing your net income before interest and income tax expenses by the amount of interest expense.

Total Debt to Current Debt – This ratio shows the proportion of a company's debts within the present operating year. It further shows whether the company might be exposed to unusual financial strains from debts maturing during the current year. It is calculated by dividing your companies total debts by its current debts.

Total Debt to Total Equity – This ratio, also known as the debt-to-asset or debt-to-

The Three Most Important Financial Ratios

Current Ratio	=	Current Assets / Current Liabilities
Quick or Acid Ratio	=	(Current Assets - Inven.) / Current Liabilities
Debt to Equity Ratio	=	Total Debt / Total Equity

The three financial ratios shown above play an important role in the granting or denial of loan request. Small businesses should calculate and monitor these financial ratios as part of their working capital management policy.

equity ratio, looks at the ability of a business to repay long-term debt. It is of primary concern for every business owner for it is given special focus in the *American Banker's Association* guidelines for evaluating a business.

The debt-to-asset ratio shows the degree of financial leverage. It is used to measure the extent to which your company relies on borrowed funds by comparing what is owed (debts, borrowed capital and other liabilities) to what is owned (assets, equity capital, net worth and money invested by the owner). This ratio is calculated by dividing total liabilities by total equity. As a rule, you should avoid borrowing so much that this ratio becomes dangerously high.

If you have to borrow, do not borrow against futures sales. When borrowing, do so only against assets. ***SUPERTIP***

If you owe $100,000 and have total assets of $200,000 than your debt to asset ratio would by 1:2 or 50 percent. This means that the assets are twice as large as the debts. The company therefore presents a healthy financial picture.

NOTE It should be obvious that a banker only want to lend money to a successful business. The banker also wants to know that the owner has at least as much at stake as the bank, and preferably twice as much. Bankers want a strong debt-to-equity ratio (1:2/1:1).

Industry Performance

Bankers and investors will also examine the current state of the industry, including its past, recent and future performance.

Liquidity of Company Assets

Banks and investors need to know your current assets such as inventory and receivables (used as collateral for short-term loans), as well as your fixed assets such as land, buildings and equipment (used for collateral for long-term loans). They will use this information to determine the liquidity of your business i.e., how easily your assets can be converted into cash, in case your business goes bankrupt.

Management Experience

A vital ingredient of every startup loan application is management expertise. Loan officers are emphatic on this point for two valid reasons:

ONE: It has been shown that lack of management expertise is the single biggest cause of business failure; an inexpert owner-manager jeopardizes the loan the might have been made by the bank.

TWO: During a number of years, a decade or more ago, when banks and the SBA were rather loose with loans and often lent money based on minority needs rather than business expertise, the bankruptcy rate was extremely high.

A request for a loan in excess of five to eight times the cash flow of a business makes investors uncomfortable. ***SUPERTIP***

Loan officers and investors will also look at your reputation and integrity (have you kept your promises in the past), your proven ability and experience (have you previously managed or owned a successful business in the past), as well as the reputation and experience of all key individuals in your management team. In general, they don't like it when they see new entrepreneurs working out of their field of expertise. They will also consider your age (and that of your supporting team), your commitment, and the delegation of control.

NOTE In addition to your own management experience and the experience of key individuals within your company, banks and investors may also want to know your personal financial history (see **page 83** and **page 84** for calculating your *Personal Net worth* and *Net Income*).

The habit of borrowing small sums of money – anticipating pay-day – is a pernicious practice and breaks many a friendship. It is no kindness to loan money to a professional borrower.
ELBERT HUBBARD

Potential for Involvement in Key Decisions

Although, this is not always the case, many investors want to be involved in key management decisions and furthermore may want to function as directors or officers of the company. Considering it is their money you will be spending, this point of concern seems reasonable.

Potential Growth

Banks and investors will also analyze your expected rate of growth. They don't like to see companies growing too slow or too fast.

Proven Credit Rating

Banks and investors like to invest in companies with solid credit ratings – they need to know you will pay interest and principal payments on time. Records and references for loans previously paid provide excellent proof. In addition to your company's credit rating, banks and investors may also want to know your personal credit history.

*Developing a Good Credit Rating –*The amount of available funds an entrepreneur can draw from an outside resource – money from a bank or goods from a supplier – is the business's available credit. A good credit standing depends on reputation, past dealings with the bank or suppliers, and the real assets pledged to secure the credit (e.g., securities, real estate, salable assets, or title to good being purchased).

It is a good practice to establish credit at a bank, even if it is not needed. Need for money can often come suddenly and unexpectedly, and the establishment of credit at a bank does not happen quickly.

Investors are impressed by an efficiency quotient that indicates an ability to effect savings.
SUPERTIP

Making loans and paying them back promptly is one good way to establish credit with a bank. Doing business with a manufacturer or other supplier over a period of time and paying bills promptly (taking discounts if they are available) is also a way of building credit with trade sources and establishing a good credit rating.

Regular Financial Reporting

Banks and investors usually want to see tight financial controls in place and prompt financial reporting. They like to have, for example, cash flow budgets updated monthly and a list of aged receivables and payables, all preferably prepared by outside accountants. They also like to be informed of any major changes before they happen; new and large order anticipated; plans for expansion; additions to premises; and whether you are going to be late.

NOTE Banks and investors like to know that you will give them the bad news as well as the good news. They need to be informed of things like receivables lengthening (A/Rs not being paid); inventory turnovers slowing down; payables becoming demanding; and losses of major contracts or orders. They want to know this because they can't help you if they don't know in time. They may for example, be able to establish a credit line in anticipation of needs determined from your cash flow.

Banks and investors usually want to see tight financial controls in place and prompt financial reporting.

APPLYING FOR A LOAN

OBTAINING FINANCING takes persistence. You may be turned down many times before someone agrees to provide funds. However, don't be discouraged. There are many sources who may be willing to help finance your business. As long as your idea is sound and you are willing to risk a large portion of your assets, as well as, those of a potential lender, you have hope.

Capital isn't scarce; vision is.
MICHAEL MILKEN
Junk-bond Creator and Investment Banker

The most important point to keep in mind when dealing with a bank is that bankers don't like risk. Their primary concern is the safety of their funds. It is also important to realize that financing takes time. Be prepared to wait week or months before any money actually changes hands.

NOTE Seeking funds from a bank for a start-up can be very discouraging. Lenders usually prefer to lend to established businesses. Keep in mind, the first responsibility of a bank is to protect its depositors.

Understanding the Loan Process

Borrowing from a bank is a contractual obligation. The banker provides the money and in return, expects a number of things to take place. Most importantly, the banker expects the payment of interest and orderly reduction of capital, maintenance of any collateral possessions, and the provision of timely financial information. As a rule, these conditions are set out by the banker prior to any funds being disbursed by the bank. In general, fixed assets are used to finance long-term loans and working capital (e.g., accounts receivable) is used to finance short-term loans.

NOTE Banks want to help but ONLY if they can profit in the process and be assured that they will get back their money plus a tidy little profit (interest).

Don't approach lenders when you are desperate for cash. Plan of your financial needs well in advance. ***SUPERTIP***

What to Prepare for Your Bank Loan Application

Many of the major commercial banks have streamlined their loan approval system to provide a faster response to the client. It must be pointed out, however, that the bank must be given sufficient information to prepare the credit application in detail.

Banks needs to know:

- how much money is needed
- what it is needed for; a plan on how the funds will be used
  - what terms can be afforded
  - how long will it take to pay back the loan out of the profits of the business (loan repayment plan)
  - whether the loan will really do the job it is expected to do
  - how much money you yourself plan to invest (if your company is a start-up company)

Banks also need to have a business plan that includes a detailed description of your business, your experience and the experience of management, personal financial statements, business financial statements including income statements and balance sheets, a detailed projections of how much you plan to earn, and a list of collateral with their estimated value offered to secure the loan.

SBA's Loan Application Form 4 – SBA's Loan Application Form, commonly refered to as *Form 4*, is more detailed than most bank forms, because banks usually have the advantage of prior knowledge of the applicant and his or her activities, while the SBA usually does not. Furthermore, the longer maturities offered on SBA loans ordinarily require more information about the applicant.

While analyzing the balance sheet and the income statement, sales and operating ratios should be calculated in order to point out areas requiring further study. Key ratios are current ratio, quick ratio, accounts receivable turnover, inventory turnover and sale/accounts receivable.
SUPERTIP

Before filling out an SBA loan application, you should talk with an SBA representative, or your accountant or banker, to make sure that your business is eligible for and SBA loan. Because of public policy, SBA cannot make certain types of loans, nor can it make loans under certain conditions. For example, if you qualify for a loan on reasonable terms from a bank, SBA cannot lend you money.

You also are not eligible for an SBA loan if you can get funds by selling assets that your company does not need in order to grow.

NOTE SBA Form 4 (5-92) Previous Edition is Obsolete.

Parts of the SBA Loan Application Form – The SBA Loan Application Form asks for the following information, which is typical of most loan application forms:

- Purpose of the Loan
- Amount Requested
- Type of Loan Requested (specify terms desired)
- Use of Proceeds (such as land acquisition, new construction, machinery and equipment, inventory, working capital, or acquisition of an existing business
- Source of Repayment
- Previous SBA or other Debt
- Present Debt

It is estimated that the SBA Loan Application Form takes 19.8 hours to complete. ***FUNFACT***

- Brief History of your company and expected benefits you will receive from the loan
- Nature of your Business (including product descriptions, market area, major customers, suppliers, competition, facilities, employees, unions and method of distribution)
  - Management (including a brief description of education, technical, age and business background)
  - Key Advisors
- SBA FORM 912 (Personal History Statement)
- Schedule of Collateral offered (borrower' assets that are pledged to

the lender to guarantee the loan)

NOTE Most sections of the SBA loan application are self-explanatory; however, some applicants have trouble with certain sections because they do not know where to get the necessary information requested. The collateral section is an example.

- A Current Personal Balance sheet (SBA Form 413 may be used for this purpose for each stockholder with 20% or great ownership
- The last three years and current within 90 days of filing the application: Balance Sheet, Profit and Loss Statement; Reconciliation of Net Worth
- A Schedule of Aged Accounts Receivable and Payable (current within 90 days)
- Three Years of Business Tax Returns
- List of Co-signers and/or Guarantors (if you have any)
- List of Machinery you are buy including costs and suppliers.

A debt lender wants to see a "Schedule of Aged Accounts Receivable and Payable" (current within 90 days)

NOTE If you are applying for a construction loan you may need to provide estimates of the costs, sources of additional funds and copies of preliminary construction plan and specification.

What Do Debt Lenders Look For – Questions They Like to Ask

A debt lender will evaluate your loan request by considering answer to several key questions:

- Can you offer reasonable evidence of repayment ability – either established earnings (for an existing business) or income (profit and loss) projections for a new business.
- Do you have sufficient management experience to operate the business?
- Do you have enough equity in the business? Equity provides what lender call a "cushion" for creditors.
- Do you have a reasonable amount of collateral (assets to be acquired, residential property).

The investor will need documentation of virtually every statement that you make. If you say your business will grow by 10 percent per year for five years, be prepared to support your claim with facts & figures.
POWERPOINT

- Can you provide the necessary data to backup your projections?

A debt lender will also check to see if there is:

- A written business plan
- A good working relationship with the banker (keep the m informed on a quarterly basis)
- An accurate balance sheet for the past two years, with a projection for the next two years. Historically, the balance sheet has been the primary financial document used by loan officer and other in the financial community to determine the financial health of a business. It is still necessary to include balance sheets in

the loan proposal package.

NOTE In filling out your "Balance Sheet" as of ________, 19____, Fiscal Year Ends _____," remember that you must show the condition of your business within 60 days of the date on your loan application.

- A strong debt-to equity ratio
- A source of funds statement for the past two years with a projection for the next two years.

NOTE The source and use of funds statement, more than any other document, lets the loan officer know if the business is viable. It is also essential for the management of cash flow and is an essential operating document even when a loan is not being requested

You and I are the same. We both screw peo-ple for money. ***RICHARD GERE*** *Investment Banker, to pros-titute Julia Rob-erts in "Pretty Woman"*

- A personal financial statement. Even when the business is incorporated, most lending institutions assume they are lending money to the owner personally.
- The owners' personal résumé. A well-written and professionally prepared résumés is an indispensable document for obtaining small business loans in today's market. Obtaining a small business loan takes personal salesmanship, and the owner must demonstrate competence to run the business. A well-prepared résumé informs the loan officials that the owner is qualified to manage the business and repay the loan on schedule.

Checklist of Questions Lenders Like to Ask ☑

Credit Worthiness:

- ❑ What is your character? Will you want to repay the loan? How capable are you in managing the business? Will you be able to repay the loan?
- ❑ What is the specific purposes of the loan? Is it a short- or long-term need?
- ❑ Do you have a clear financial plan and forecast showing why you need the loan and how you will pay it back?
- ❑ Is the loan request large enough to cover an unexpected change in your situation, but not so large that is repayment will be a heavy burden?
- ❑ What is the general economic outlook for your business and industry?
- ❑ Do you have a reasonable amount at stake in the business?
- ❑ What collateral is available to secure the loan amount?
- ❑ Are the business' books and records up-to-date and in good condition?
- ❑ Does the business have a lawyer and/or accountant?
- ❑ Who are the customers and what percentage of total sales do the largest customers represent?

The success of so many new immigrants from Southeast Asia in North America is a result of ethnic networking – established Asia-American businesses provide a "hui" to finance startup enterprises and provide entrepreneurial guidance to the newer arrivals.
FUNFACT

- ❑ Are all obligation paid promptly?
- ❑ What is the insurance coverage?

Accounts Receivable:

- ❑ What is the quality of the accounts receivable?
- ❑ Have any been pledged to another creditor?
- ❑ Are customer paying your promptly?
- ❑ Is there an allowance for bad debts?

Inventory:

- ❑ Can the merchandise be sold at full price?
- ❑ How much raw material is on hand?
- ❑ How much work is in progress?

Debt lenders like to ask, "Who are your customers and what percentage of total sales do your largest customers represent?"

- ❑ How much of production is finished goods?
- ❑ It too much money tied up in inventory:
- ❑ Is the inventory turnover in line with industry norms?

Fixed Assets & Equipment:

- ❑ What is the type, age and condition of the equipment?
- ❑ What are the depreciation schedules?
- ❑ What are the details of mortgages or leases?
- ❑ What are the future fixed asset and equipment needs for the company?

Installment Loans, Simple Interest Rate Loans & Lines of

Credit

There are three basic kinds of loans:

- add-on interest rate or installment loan
- lines of credit
- simple interest rate loan

Add-on Interest Rate or Installment Loan – An installment loan is an agreement to provide a lump sum amount of money at the beginning of the loan. The loan is paid back in equal amounts over the course of a number of years in equal periodic payments. There are two kinds of installment loans: short-term and long term.

Short-term Loan – Short-term bank loans are generally paid in less than a year. A short-term loan can be used, for example, to finance a seasonal buildup in accounts receivable or to finance a seasonal buildup in inventory e.g., a massive Pre-Christmas Sale. Lenders usually expect these loans to be repaid after their purposes have been served. In the first example, once the outstanding accounts have been paid by the customers and in the second example, once the Christmas inventory has been

Bank Loan Turn Around Time

BANKS HAVE DIFFERENT levels of management to analyze different loans of different values. In general, the greater the loan being requested, the longer the turn around time: account manager 1 to 2 days; unit manager 1 week; regional or divisional manager 2 -3 weeks; head office credit unit 1 month.

sold and cash collected.

Long-term Loan – A long-term loan is a formal agreement to provide funds for more than one year. These funds are usually used for expansion or an improvement that will benefit the company and increase earnings. An example is the purchase of a new warehouse that will increase capacity or a machine that will make an key manufacturing process more efficient and less costly. Long-term loans are usually repaid from the resulting profits.

I once wondered how the banks made their money, but when I procured a loan, I found out.
E. W. HOWE

Line of Credit – A line of credit is an arrangement in which the bank disburses funds as they are needed, up to a predetermined limit. The customers may borrow and repay repeatedly up to the limit within the approved period (usually one year). The most popular form of a line of credit is the revolving credit account.

NOTE A line of credit is an informal understanding between bank and a borrower related to specific amounts of funds available for future financing purpose.

Revolving Credit Account – A revolving credit account is a formal line of credit offered to larger businesses in exchange for up-front fees and standard interest payments. In return, the bank has the legal obligation to fulfill its commitments under the formal agreement.

Simple Interest Rate Loan – The simple interest rate loan is a loan which provides the borrower the face value of the loan.

The borrower then repays the principal plus interest at maturity.

Operating, Working, Growth & Equity Capital Loans

Four other basic categories of loans worth defining include:

- operating loans
- working capital loans
- equity capital loans
- growth capital loans

An operating loan provides funds to look after day to day operating requirements of a business.

Operating Loans – An operating loan provides funds to look after day to day operating requirements of a business. It is normally of a revolving nature (e.g., a revolving credit account) and is usually secured by receivables, inventory, a debenture or fixed assets.

Working Capital Loans – A working capital loan is used to meet fluctuating needs that must be repaid in cash during the business's next full operating cycle, which could be more than several years. Companys which have a heavy investment in fixed assets but due to unforseen circumstances have limited working capital, may borrow funds against the security of these assets. A working capital loan can, for example, provide the cash necessary to meet maturing obligations, stockpile inventory and take advantage of trade discounts.

NOTE If your business has great potential or is in good financial condition, as shown by its balance sheet, you can borrow money to keep the business operating during start-up and slow sales periods. Working capital loans are often required when a business needs more money than can be generated by present sales. The loan can be repaid during the months when sales are greater than expenses.

Equity Capital Loans – An equity capital loan is used to meet permanent needs. If you seek equity capital, it must be raised from investors who will take the risk in return for some combination of dividend returns, capital gains or a specific share of the business.

Growth Capital Loans – A growth capital loan is used to meet needs that are to be repaid with profits over a period of a few years (usually not more than seven). If you seek growth capital, you will be expected to show how the capital will be used to increase your profits enough to be able to repay the loan.

Adequate working capital is needed for success and survival, but cash on hand (or lack of it) is not necessarily an indication that the business is in bad financial shape. ***POWERPOINT***

Loan Application Summary

Factors Your Lender May Use to Evaluate Your Application:

1. Your character, integrity and overall management skills.
2. Your company's track record i.e. its sales and profits.
3. Your product and its relative importance to the market.
4. Your financial statements preferably accompanied by a CPA's statement.
5. A description of the purpose of the loan.
6. Your company's ability to provide data to the bank both accurately and timely.
7. The primary and alternative sources of repayment.

Factors Your Lender May Look Negatively on In Approving Your Loan:

1. Accounts receivable past due, indicating that cash is coming too slowly.
2. Accounts payable abnormally extended.
3. Poor inventory operation, such as low turnover and large back orders.
4. High debt-equity ratio, signifying large outstanding loans.
5. Large withdrawals of profits by company officer's owners.
6. Attempts to borrow short-term fund to meet long-term needs.
7. Insufficient financial data.
8. Poor credit rating for principal business owners/officers.
9. Personal problems of executives.

THE LOAN AGREEMENT

A LOAN AGREEMENT is a specially made document that fully states all the terms and condition of a loan. It gives the amount of the loan and terms of repayment, identifies the principle parties and lists any restrictions placed on the borrower. Below are loan agreement terms and issues worth noting:

Limitations – Banks often include limitations in a loan agreement that restrict what an owner can do. Limitations are spelled out in the covenant section. If the company is a good risk, the limitations will be minimal. If on the other hand, the bank feels the company is in a higher risk category they may impose greater limitations. Limitations imposed may include stricter repayment terms, the use of collateral, and more detailed periodic reporting.

Read the fine print in the loan agreement. Make sure you understand the exact interest rate scenario. ***SUPERTIP***

Negative Covenants – Negative covenants are restrictions placed on the borrower by the lender. Some examples are limitations on the borrower's total debt, agreement not to pledge assets to other creditors and limitations on the amount of dividends that may be issued.

Positive Covenants – Positive covenants are actions the borrower must agree to. They include carrying adequate insurance, adhering to the repayment schedules, maintaining a minimum working capital, and supplying the lender with regular financial statements and reports.

NOTE Loan agreements can be amended

from time to time and exceptions made. With the consent of the lender, certain provisions may be waived from year to year.

Terms in the Agreement You Should Be Familiar With –

Amortization – Gradual reduction of a debt by periodic payments sufficient to cover current interest and to eliminate the principal at maturity. Amortization periods are generally 10, 15, 25 and 30 years.

Capital – Capital can refer to:

a) assets less liabilities; represents the ownership interest in a business

b) a stock of accumulated goods at a specified time, in contrast to income received during a specified time

c) accumulated goods devoted to the production of goods

d) accumulated possession of assets used to generate income

Compensating Balances – *Some banks require their borrowers to maintain compensating balances, which are an average demand deposit equal to a certain percentage of the loan amount.*

Carrying Costs – Inventory costs associated with storage, handling expenses, insurance, taxes, obsolescence and interest charges.

Compensating Balances – Some banks require their borrowers to maintain compensating balances, which are an average demand deposit equal to a certain percentage of the loan amount.

Credit Period Length – Time allowed before the credit buyer must pay for credit purchases.

Credit Policy – Actions taken by a business to grant, monitor and collect the cash for outstanding accounts receivable.

Twelve Strategies for Negotiating Financing

Discuss and negotiate the lending terms before you sign a loan agreement. It is good practice, no matter how much you need the money. Chances are the lender may be willing to "give" on some of the terms. Negotiate terms which you know you company can meet and prosper by.

A lending limit is the amount of money they are able to lend on their own authority, without having the request approved by a higher ranking authority.

NOTE You and the investor have different goals. The lender's goal is protection of his or her investment, while yours is financial growth. These diverging goals often create conflicts.

1. **Prepare a comprehensive business plan.** Include an overview of competition, composition of management and staffing, marketing plans, and pricing strategy, income projection for one year and a cash flow projection.
2. **Be prepared to explain uses and benefits of the proposed loan.** Summarize the information in the "Sources & Funds Statement" in your business plan (see Guidebook #11).
3. **Find the appropriate person to speak to.** Find out who will make the ultimate decision about your financing request, and then deal with that person directly.
4. **Be aware of the lending limit of**

the person whom you are dealing with. Most commercial lenders have what is commonly referred to as a lending limit. A lending limit is the amount of money they are able to lend on their own authority, without having the request approved by a higher ranking authority. It is perfectly acceptable to ask the amount of the lending limit before setting up an appointment and, what's more, its advisable.

The chances of obtaining outside financing improves as the size of the business increases. Not only does the willingness of the lender to participate in the transaction increase, the number of potential lenders increases as well.
SUPERTIP

5. **Choose a lender with whom you feel comfortable.** Be sure to settle on a lender who can give adequate attention to your account and who explains all aspects of the financing relationship clearly and thoroughly.

6. **Dress conservatively.** Like almost everyone, investor and lenders feel most comfortable around people like themselves. A suit and tie are recommended for men, a jacket and skirt for women. Avoid overly elaborate accessories. Remember you are trying to give an impression of considerable good judgment.

7. **Give an impression of confidence and competence.** It is reasonable to feel a little nervous when applying for financing, but be carefully

not to let your nervousness cloud your judgment. The investor needs to have a high degree of confidence in your ability to repay the debt or generate a profit.

NOTE Remember that the investor is dependent upon you, just as your business is dependent upon the investor. You are both in a position to help one another.

8. **Do not overstate your financial strength.** Be realistic. Guard your credibility. It's not a very good policy to say something you can't support.

9. **Provide complete information about your business.** It will be far better for a negative aspect of your business to be handled openly than for it to come up later under less favorable circumstances. This does not mean that you are under obligation to reveal all your fears and concerns about the business and its operations. It does mean, however that you've an obligation to disclose material or relevant facts about your business.

People are saying, "Oh, this was Prince's big gamble." What gamble? I made a $7 million movie with somebody else's' money.
PRINCE
Rock Star, commenting on his film "Graffiti Bridge," which flopped at the box office

10. **Carefully check all terms of the agreement.** Be sure you know what you are signing. It is perfectly appropriate to ask that your attorney or accountant review the conditions of the agreement. The time to discuss alternatives is before the deal is finalized. Once

you have signed an agreement, you are legally bound by it.

NOTE Pay special attention to clauses that may present serious hardships to your busines. Keep in mind that it is the investor who will prepare the loan agreement, not you. Given this, it is not unreasonable to expect the terms to make their life easier not yours. Thus, it is important for you to recognize and seek to prevent the insertion of any clauses or conditions that may be difficult to meet or live by.

A small difference in interest rates can have a big impact on your payments.

11. **Don't be afraid to negotiate interest rates and fees.** A small difference in interest rates can have a big impact on your payments. Consider the following example, a ten-year loan for $50,000 at 12% interest required monthly payments of $717. The same loan at 15% interest requires $807.

Fees, too, can drastically alter the total amount you are paying for financing. Typically, you will be asked to pay "Points," which are a percentage of the total loan, due at the time the loan is made. If for example, you borrow $50,000 and are told that there is a 2 percent commitment or origination fee, you can expect to pay $1,000 in fees to borrow from this source.

All lenders charge different rates and fees. If the lender seems receptive, attempt to reduce the charges you will incur. In the worst case, the lender will tell you that the lending conditions cannot be change. You've lost nothing by trying to minimize your costs.

NOTE The interest rate charged usually reflects the level of risk the investor is undertaking be lending your money. Investors will charge you lower interest rates if they feel there is a low risk of the debt not being repaid. Investors will raise interest rates if they are concerned about your ability to repay the debt or if you have a history of slow payments to lenders as shown on your personal or business credit reports. A new business is likely to be charged a higher interest rate than a well-established business because the lender will feel a new business represents a greater risk.

The interest rate charged usually reflects the level of risk the investor is undertaking be lending your money.

12. After negotiations, ask to see the final loan agreement paper once more before the loan closing. Reputable lenders will be glad to comply. While you're mulling over the terms, it is a good idea to get advice from associates and advisors.

MAKING THE RIGHT DECISION

BEFORE YOU get all exited about borrowing money to start your business, you should seriously sit down and ask yourself if you really need to borrow at all. Loans or credit allow you to get started, obtain equipment, build inventory, develop new lines of merchandise, or expand – but remember, it all has to be paid back sooner or later.

Marketplace competition is no deterrent to lenders. The presence of competitors can be interpreted as offering potential purchases.
POWERPOINT

Borrow as long as your company's cash flow is adequate to cover the payments for both principal and interest on the funds borrowed. And only borrow if it is profitable to borrow. For example, if borrowed capital costs 15% per annum and can be used to earn 20% then it is advantageous to borrow. If however, the borrowed money costs 15% per annum but earnings are only 10% then the rate of return on invested capital is in question.

The bottom line is, do not borrow unless you have to. Save your credit for when you really need it.

NOTE Should borrowed capital be repaid as fast as possible? Borrowed capital in a business should be used in the same way that material equipment and other assets are used. It should always be seen and treated as an expense of doing business.

Debt or Equity Financing?

In deciding how to finance your business, you need to consider the following:

- How much control of your new business can you comfortably give up?
- Which facts will debt and equity financiers be interested in? How do debt and equity requirement differ?
- How highly leveraged do you want your company to be? The higher the amount borrowed compared to the amount of equity, the higher the leverage.

Finding the Right Bank or Investor

Finding the right bank or investor can be difficult. Small banks are still easier to approach when a startup loan is needed; larger or multi-branch banks are more impersonal, require OKs from high officials at the main office, and often rely on an SBA guarantee. In all cases, a complete, credible, verifiable business plan is required as proof to the loan officer that you know where you are going.

Always try to rub up against money, for if you rub up against money long enough, some of it may rub off on you.
DAMON RUNYON
Guys and Dolls

Start first by approaching people you know, i.e. friends, banks, credit unions, or trust company managers, lawyers, accountants and doctors. They in turn may know of possible investors. If your business concept exhibits high growth potential, a second alternative is to approach a venture capital company. Either way take a moment to consider the investor's needs, which may differ from a lender's needs (see Guidebook #89 for more info on finding a good banker).

PERSONAL INCOME STATEMENT

Name: Jack and Louise Mulligan | **Date:** Oct. 23, 1995 | **Period:** one year

INCOME

Gross Salaries	42,000
Bonuses & Commissions	
Spouse's Gross Salaries	35,000
Rental Income	6,400
Annuities and Pensions	
Dividends and Interest	340
Sale of Personal Capital Items	
1. Weekend Concessions	7,500
2. Other	100
TOTAL Gross Income	91,340
Less Taxes	
Personal Income Tax	28,767
Other Taxes	
A) TOTAL NET INCOME	62,573

EXPENSES

Household	
Rent/Mortgage Payments	13,000
Household/Apt. Insurance	366
Property Taxes	2,200
Utilities (telephone, power, etc.)	1,650
Maintenance & Repairs	1,200
Furniture & Appliances	2,500
Stereos, TVs, & Computers	1,000
Day Care Services	
Other Household Expenses	1,500
Transportation	
Auto Loan/Lease Payments	3,300
Auto Insurance	550
Gas & Oil	1,100
Repairs & Maintenance	800
Licenses, Fees & Parking	275
Other Transportation Exps.	20
Personal	
Food	4,800
Clothing	2,200
Laundry & Cleaning	80
Music, Movies & Theater	1,000
Drinking, Dining & Dancing	1,200
Sporting Activities	250
Vacation & Travel	2,000
Gifts, Donations & Dues	1,000
Education, Books & Mags.	300
Medical/Dental/Life Insurance	2,367
Doctor & Dentist Fees	300
Prescription Medicines	150
Loans & Credit Payments	225
Investment & Savings Plans	6,000
Other Personal Expenses	300
1. Mother's False Teeth	950
2. Mountain Bikes	1,000
B) TOTAL LIVING EXPENSES	53,583

TOTAL DISPOSABLE INCOME (A - B) **$8,990**

PERSONAL NET WORTH STATEMENT

Name: Bernard Jackson **Date:** Oct. 23, 1995

ASSETS		LIABILITIES	
Cash		Unpaid Bills	
Cash On Hand	350	**Credit Cards**	2,276
Checking Accounts	1,250	**Income Taxes**	2,000
Saving Accounts		**Insurance Premiums**	378
Money Owed to You	2,200	**Other Unpaid Bills**	785
Investments		Installment Loans	
Mutual Funds	35,600	**Automobile**	17,200
Stocks & Bonds		**Other**	
Savings Bonds		Long Term Loans	
Other		**Bank** (home renovations)	6,500
Cash Surrender Value		**Education**	
Annuities		**Home Equity**	
Life Insurance		**Other**	
Pension Fund	150,000	Real Estate Loans	
Retirement Plans	120,000	**Home**	**145,000**
Personal Property		**Other**	
Real Estate	250,000	Other Liabilities	
Furniture/Antiques	23,000	**Alimony Payments**	
Art/Jewelry	6,000	**Accounts Payable**	
Vehicles	24,000	**Notes Payable**	
Other Assets		**Contracts Payable**	
Accounts & Notes Rec.		**A.** Doctor's Bill	7,540
A. Coin Collection	2,000	**B.** Grand Piano	12,000
B. Horse	10,000	**C.**	
C. Miscellaneous	3,000		
TOTAL ASSETS	**$947,800**	**TOTAL LIABILITIES**	**$193,679**

NET WORTH $754,121