HOME-BASED AND MICRO BUSINESSES

CASHING IN ON BUSINESS OPPORTUNITIES

SEARCHING FOR CAPITAL

PREFACE

The material contained in the following lesson, along with the accompanying presentation materials, is designed to assist the home-based or small business owner in acquiring outside capital for his or her growing enterprise.

This program is designed to be delivered in a seminar/workshop format. It is recommended the material be presented in two one-hour sessions, to allow participants plenty of time to work through the material and to ask questions. In the second session they could also begin preparing their own loan packages. The instructor needs to have examples of a balance sheet and income statement available to the participants so they know what potential lenders will be asking from them.

Goal: The goal of this lesson is to introduce home-based and micro business owners to some of the ways of acquiring outside capital.

Objectives: As a result of this lesson, participants will learn:

- Sources of outside capital.
- Types of loans offered by commercial lenders.
- One method of preparing a loan package.
- Tips on establishing and maintaining a working relationship with a commercial lender.

HANDOUTS

Handout 1 – Money Needs for the First Three Months
Handout 2 – Cost-of-Living Budget
Handout 3 – Cash-Flow Projections

INSTRUCTIONAL MATERIALS

Inadequate capital is the cause of many home business failures. Enough capital is needed not only to start up the business, but also to operate it through the hard times and to provide an opportunity for growth and expansion. There are several sources to consider when looking for financing for your business. But first you need to consider how much money you are going to need.

HOW MUCH WILL YOU NEED?

SLIDE 3

HANDOUT 1-3

The financial needs of your business will vary according to these factors:

- The type of business being started or operated
- The types of products or services that will be provided
- Your potential suppliers
- Your geographic location
- Your customers' purchasing power
- Competitors in your trade area
- Your cost of labor
- General economic conditions

If you are starting a business, you will need capital for equipment, any household or leasehold improvements needed to making your working space more functional or convenient for customers, obtaining licenses or permits, beginning inventory and supplies, and living expenses for at least the first three months. Handouts 1-3 can help you estimate how much you will need for the first three months of operation plus how much you will need for family living expenses during these months.

You will also need money for operating capital to pay employees, utilities, advertising and promotions, insurance, and other day-to-day expenses before the proceeds from your business will support the enterprise. Preliminary cash-flow analysis can help you determine how much money you will need. Cash-flow analysis matches the expected outflow for expenses with expected income on a month-by-month basis. Estimate as many items as possible from current costs in your trade area.

WHERE WILL THE MONEY COME FROM?

SLIDE 4

There are several sources to consider when looking for financing. Which one is right for you depends upon your business situation—whether your business will operate in a rural or urban setting, whether you will operate a relatively small or large business, and whether your business will primarily provide services, be a retail outlet, or will manufacture products.

Personal savings. The first place to look for money is your own personal savings. Most new businesses are started with the primary source of capital coming from savings and other forms of personal resources. Personal resources can include profit-sharing or early

retirement funds from a previous job, real estate equity loans, cash-value insurance policies, or credit card advances.

It is important to remember that even if you do not have sufficient saving to start a business, lending institutions are going to require a portion of a project's financing to come from the borrower. A borrower will need to have "skin in the game" before lending institutions will consider providing capital.

Life insurance policies. A standard feature of many life insurance policies (not term insurance) is the owner's ability to borrow against the cash value of the policy. The money can be used for any business or personal need. It takes about two years for a policy to accumulate sufficient cash value for borrowing. You may borrow up to 95 percent of the cash value of the policy for an indefinite period of time. As long as you continue to pay the insurance premiums, paying the interest you owe can often be deferred. The loan will reduce the face value of the policy, and in the case of death, the loan has to be repaid before the beneficiaries of the policy receive any payment.

Home equity loans. A home equity loan is similar to a second mortgage. It is a loan backed by the value of the equity you have built up in your home. For example, if your house is worth $60,000 and the outstanding balances on outstanding mortgages sums to $50,000, you have $10,000 in equity that can be used as collateral for a home equity loan or line of credit. Some home equity loans are fixed-rate loans paid to the borrower in a lump sum while others are set up as a revolving credit line from which you draw only the amount you need at any one time, using a special check or credit card provided by the lender. Interest on home equity loans is tax-deductible; this makes them particularly attractive to borrowers.

Note: It is very important to remember the simple fact that if your business does not succeed, you may need to be willing to sacrifice your home.

Friends and relatives. Many entrepreneurs look to private funding sources, such as friends and family, when starting out in a business venture. One benefit to this type of source is that the money is often loaned at a low interest rate.

If you borrow from a friend or relative, develop a loan agreement that specifies the amount borrowed, the length of the loan period, the interest, schedule of payments, and any collateral (property that belongs to you used to secure the loan). If the lender is cooperative and doesn't need the money back immediately, he or she may agree to a demand loan—you agree to pay back the full amount if and when the lender asks for it. Although a demand loan doesn't specify regular payments, try to repay as much as you can, as soon as you can.

Banks, savings and loans, and credit unions. Banks and other commercial lenders are a popular source of business financing. However, most lenders insist on a solid business record and plenty of collateral—both of these are very hard to come by in a start-up situation. Once your business is well underway and you can supply profit

and loss statements, cash flows and balance sheets, you may be able to borrow more operating capital or the money you need for expansion. Banks will look at a potential lender's personal credit history when they evaluate a potential loan. Also, it is important that a borrower is completely honest with a lender or intermediary with regard to their personal finances and credit history. It is very disconcerting to have past credit problems surface later on in a loan process or even after resources have been spent on a potential business opportunity.

Commercial finance companies. Commercial finance companies are potential sources of capital when more traditional sources of financing are unavailable. Commercial finance companies may be more willing to rely on the quality of your collateral than your business's track record or profit projections to repay the loan. If you do not have substantial personal assets or collateral, a commercial finance company may not be the best place to secure business capital. Also, the cost of finance company money is usually several percentage points higher than other commercial lenders due to the risk that the lender is assuming by providing funds to a lesser credit-worthy borrower.

Venture capital firms. Venture capital firms provide capital to unproven young businesses in exchange for equity or partial ownership in the firm. Generally they are looking for high-growth businesses with a patentable product, technology base, or unique market niche. Even though equity loans don't burden a new business with loan repayments and interest charges, they do reduce the primary owner's share of the profits.

Venture capital firms generally will want a management stake in a business they finance. This may result in a partial loss of control of your business. Venture capital firms are generally looking for high rates of returns on their investments and if you are unable to deliver, they may insert members of their management team into the business to increase the chances of making their expected returns.

Venture capital firms may also insist on being issued preferred stock. This insures that they will receive their money first before other shareholders if the business fails or is sold.

Government programs. Federal, state, and local governments have several programs designed to assist the financing of new ventures and small businesses. The best known lender is the Small Business Administration (SBA). See the following pages for a discussion of some of the most popular SBA loans. Other government programs include Rural Economic and Community Development loans and state economic development loans.

United States Department of Agriculture Loans

USDA Rural Development. Both start-up and existing businesses may qualify for financing from this agency, formerly known as the Farmers Home Administration. Their loan program can guarantee up to 90 percent of the loan to promote economic development in rural areas. Rural areas have less than 50,000 people within a five mile radius. Interestingly, many metropolitan areas qualify for these types of loan and grant programs because of the population stipulation.

USDA guaranteed loans can be used to buy land, buildings, machinery and equipment, and for working capital just like a traditional bank loan. In fact, the USDA guaranteed loan program is administered through an

approved financial institution. The bank or lending institution has to be approved by the USDA. The borrower has to meet the lending standards of the financial institution plus the lending requirements established by the USDA. USDA-RD loans are available to businesses in most industries with the exception of agricultural production.

SLIDE 5

SBA or Small Business Administration Loans

The Small Business Administration or SBA also has a business loan program. These programs are also focused on providing funding to small businesses. The objective of the SBA loan program is to assist qualified small businesses in acquiring financing when they might not be eligible for business loans through normal lending channels. The SBA guaranteed loan program is flexible and is available to a wide variety of business purposes.

The SBA loans can be used for working capital, machinery and equipment, furniture and fixtures, land and building (including purchase, renovation and new construction), leasehold improvements, and debt refinancing (under special conditions). Loan maturity is up to 10 years for working capital and generally up to 25 years for fixed assets. The SBA provides loan guarantees, not direct loans.

The guaranteed loan program means that the money comes from your local lender, but if you were to default on your loan, the SBA repays the loan up to 85 or 90 percent of the amount borrowed. To receive this type of guarantee, a business must be able to prove that it is unable to secure reasonable financing from at least two other sources. Interest rates on loans vary from year to year based on the cost of money to the government. These are some of the financial assistance programs offered by the SBA:

7(a) Regular Business Loans: This program guarantees loans up to a maximum of $750,000. The maximum life of the loan is five to seven years for working capital, 10 years for equipment, and up to 25 years for business real estate. The standard 7(a) loan requires an extensive application and could take several weeks to get approved at a bank that is not an SBA Certified Lender.

Certified Development Company Loans or 504 Loans: This guarantee program provides fixed asset financing for the growth and expansion of small businesses. The borrower must be willing to produce 10 percent of the total amount of the loan, the bank loans 50 percent of the loan's total value, and the development company then makes a 40 percent second mortgage on fixed assets such as land, equipment, or buildings. However, this program is designed to create and retain jobs; therefore, the borrower must create one job for every $35,000 received.

Low Doc (Low Documentation) Loans: This program provides a streamlined application for borrowers with good character. The maximum loan amount is $80,000 and the maximum life of the loan is five to seven years for working capital, 10 years for equipment, and up to 25 years for business real estate.

Small Business Investment Companies (SBIC): This program is for venture-capital companies who wish to supplement their private investment capital by borrowing funds at

a preferred rate from the SBA. The SBIC, in turn, makes long-term loans or provides venture capital to small businesses.

Capital Access Loans (CAP): For borrowers with insufficient collateral for conventional financing the CAP program offers default protection to participating lenders who pay into a loss-reserve account each time a CAP loan is made. The cost to the borrower is higher than for a standard SBA-guaranteed loan, and the money is used to provide working capital for short-term needs (up to 5 years).

Other SBA loan programs include the following:

- Seasonal Line of Credit Guaranties (short term)
- Energy Loans
- Export Working Capital
- International Trade Loans
- Pollution Control Financing
- Surety Bond Guarantee Program
- Small Loan Program
- Small General Contractor Loans
- Loans to Qualified Employee Trusts
- Employee Stock Option Plan (ESOP)
- Employee Retirement Income Security Act (ERISA).

State loan programs. Most states offer enterprise development funds or micro-loan programs to businesses that meet specific guidelines. For example, businesses in need of financing to support research and development or commercialization of new technology may get funding from a program targeted at high-tech projects. These loans are typically targeted to businesses that are not eligible for conventional bank or venture capital financing. Similarly, businesses owned by women and minorities or firms who need assistance with up-front training costs associated with new or expanding industries in a state may qualify for certain types of state-sponsored financing.

Other sources of capital. Some sources of "money" are not borrowed. They include trade or supplier credit, customer advances, and leasing companies.

Trade or supplier credit: This is money you owe suppliers who permit you to carry inventory on an open account. Study the discounts for the advantages of early payment and the penalty for late payment to determine the true cost of this form of credit. While some suppliers will extend credit only to well-established, proven businesses, many will extend limited credit to new businesses to encourage another buyer for their merchandise. Trade credit is effectively used by large businesses to buy products at a lower cost than small firms. Really large, "big-box" stores can even have products made to their own specifications. Treat your supplier credit like gold. Being put on a "cash on delivery" basis because of repayment problems often signifies the beginning of the end for a small business.

Customer advances: When customers pay in installments for the work a service provider does or provide some of the materials to a product maker, they are in effect financing the business. It is not uncommon, for example, for businesses to request a deposit from customers who

order special items or request specialized work. Often such a deposit is set large enough to cover all the out-of-pocket costs needed for that specific job.

Leasing companies: Leasing business equipment is one way to reduce the need for start-up or expansion capital. Everything from office furniture to food processing equipment can be obtained from large rental companies. Leasing is generally more expensive than bank financing and is limited to items that have a long service life, are widely used, and are easily repossessed in the event of default. In many cases you may have an opportunity to buy the equipment for a previously agreed-upon amount at the end of the lease period.

TYPES OF BUSINESS LOANS

Most lenders believe a business should be started with the owner's personal assets providing much of the financing. You need to expect to invest between 10 and 20 percent of the business's total financial needs from sources other than commercial lenders and government programs. The size of your commitment is critical. Lenders will hesitate to risk their funds if they perceive you are not risking a substantial amount yourself.

Commercial financing. Traditionally, home-based and micro business owners have used local banks for their financing needs. When you borrow money from a bank, savings and loan, credit union, or other lending institution, it is important to know the kind of money you need. Here are the basic categories lenders generally use to classify loans, grouped according to the expected duration of the loan.

SLIDE 6

Short-term business loans. Business runs on short-term loans. Technically a "short term" loan means repayment in less than a year, but in real life, short-term loans often expand to two or three years. Small businesses usually seek short-term loans to finance their accounts receivable and supplies/inventory needs, especially when their business is seasonal or they deal with perishable goods. But short-term loans can also be used for many other purposes, including taking advantage of a temporary bargain on an item regularly carried in stock or taking care of an emergency. Most short-term loans fall into one of these four categories:

Line of credit: A line of credit consists of a specific sum reserved for a business to draw on, as needed, over a definite period of time, from 30 days to two years. Interest is computed only on the amount actually drawn out, but a commitment fee of 1/2 to 2 percent of the total credit line is usually charged to pay the lender for reserving funds that may not be used by anyone else. Some lenders will waive this fee if the borrower keeps a minimum balance on deposit throughout the loan period; others work out a combination of account balance minimums and commitment fees.

Lines of credit are popular because of their simplicity, and lenders have developed several credit line arrangements that fit different borrowing needs. The cheapest is the nonbinding or "uncommitted" line of credit. This may be the best option for a small business; but because it carries no guarantees, there is always the risk the credit line may dry up if the business's financial position deteriorates or if the business's industry seems headed for hard times.

Nonbinding or committed, a short-term line of credit must be periodically "cleaned up." This means that all loans must be paid up for 30 days each year. If cleaning up a line of credit constricts cash flow too much, the business can apply for a revolving line of credit, which is reviewed once a year but doesn't require clean up. Revolving lines of credit are similar to a department store's revolving charge accounts. As the business withdraws funds, the available credit diminishes and expands again with repayment. Interest is computed only on the funds actually borrowed, and usually there's no extra fee or additional cost. Revolving lines of credit are ordinarily repaid in monthly installments of interest plus principal.

Inventory loan: When a small business with seasonal borrowing needs applies for loans between $5,000 and $20,000, some lenders prefer to write what they call "short-term loans to carry inventory" with the collateral being inventory itself. Sometimes, under an arrangement called "floor planning," loans are collateralized by big-ticket items. Funds are made available for borrowing as needed; repayment is made in installments as inventory is sold and/or accounts receivable are paid. The standard inventory loan runs 6 to 9 months and requires the same 30-day annual cleanup as a line of credit if an extension is needed.

Commercial loan: Some lenders do much of their short-term lending in commercial or "time" loans, which minimize bookkeeping for both lender and borrower. A commercial loan does not require installment payments; it is repaid in a lump sum at the end of the term, which is typically 3 to 6 months in length. Commercial loans are often used to finance inventory or supplies, but they may be applied to any purpose the lender approves.

Accounts receivable financing: Some businesses that carry their own credit may find the amount their customers owe them is tying up huge sums of working capital, so they turn to their lenders for loans that will convert the unpaid accounts into cash. Generally lenders will loan only on accounts that are less than 60 days past due and on customers who are themselves credit-worthy. For receivables meeting these criteria, lenders will advance 65 to 80 percent of face value, to be repaid as customers' checks come in. The usual arrangement calls for the business to pass the checks on to the lender, which takes its portion out and deposits the rest in the business's account. Interest is charged only on the amount outstanding.

Although most accounts receivable loans are ordinarily written for one year, some lenders will work out a revolving plan. Under such an agreement, which is reviewed annually, the lender will continue to advance funds against incoming receivables. One limitation on accounts receivable financing is that some lenders will set a minimum dollar amount of qualified receivables before making the loan (for example, $10,000 in accounts receivable that are less than 60 days past due).

OTHER TYPES OF BUSINESS LOANS

Medium-term loans. Short-term loans tend to be granted by commercial lenders a relatively low level concern for collateral, since these loans are usually self-liquidating from sales made in the ordinary course of business. Medium-term loans of one to five years, which is the way most businesses finance equipment, fixtures, and expansions, are

more likely to require significant collateral. The business may see the new asset as the source of repayment in expectation of its generating increased sales and profits. However, the lender may ask for collateral in addition to the asset the business is buying, especially if the business is just getting going.

Medium-term loans, in contrast to short-term loans, may impose some operating restrictions on the business. The lender may insist the borrower maintain a certain level of working capital or a certain ratio of current assets to current liabilities. Most medium-term loans provide 80 to 90 percent of a new asset's total cost and are written for either five years with a refinancing clause or for the useful life of the asset. The typical repayment schedule calls for monthly or quarterly installments of principal plus interest.

Long-term loans. Loans that extend repayment over ten to fifteen years are the hardest to get and must be linked to some specific business purpose such as the purchase of real estate or a major expansion.

Commercial and Industrial Mortgages. Lenders will ask sharp questions about potential real estate purchases because over-commitment in bricks and mortar can bring about business failure.

However, if a business gets a chance to buy the building it is now renting, for example, most lenders will consider a mortgage loan of up to 75 percent of appraised value. Commercial mortgages may be written in a number of ways, depending upon the value of the building and the long-range profit projections of the business.

Real Estate Loan. Some businesses face the opposite problem — they own real estate and want to borrow against its value

to finance an expansion or major equipment purchase. One way to tap real estate equity without giving up a low-interest first mortgage is by adding a second mortgage — if the business has sufficient equity and a good financial standing. A "wrap-around" mortgage is an alternative for businesses in a less solid position. This differs from a second mortgage in that the total mortgage payment is paid to the lender with the wrap-around, who passes on the amount due to the holder of the first mortgage.

Equity financing. The money you put into a company or business is equity (remember from Part 3, Lesson 4 that a business's equity is equal to the difference between its assets and liabilities). Initially this money comes from your savings, personal borrowing, friends, relatives, or business associates. Eventually earnings retained in the business will increase your equity. If you form a corporation, you can buy one or more shares and lend the rest of the money to the corporation. The advantages of a shareholder's loan is that interest or dividends may be paid back when funds are available and the loan can be repaid without tax consequences.

Another form of equity financing is to sell an ownership interest in your business to a venture capital firm or other investor. Equity financing is not repaid like loans

are; investors receive a share of the business's profits. To attract investors, you need a solid business plan and financial projections that show how the business will generate an acceptable rate of return on investor money within a reasonable amount of time.

WHAT KIND OF COLLATERAL WILL YOU NEED?

Collateral is any asset you own that is used to secure repayment of a loan. If you don't pay, the lender can take possession of the collateral to sell and keep the money. Sometimes your signature is the only security a lender needs when making a loan. Other times the lender requires additional assurances the money will be repaid. The kind and amount of security needed depend upon the lender and on the borrower's situation.

Personal Assets. Any property in the owner's name can be used as collateral, along with stocks or bonds, savings accounts, certificates of deposit, and equity in the owner's personal residence. Such collateral is often readily acceptable, and a personal loan may be easier to negotiate than a business loan. Or a business loan may have to be secured with a personal guarantee, which amounts to the same thing. One caution with regard to personal guarantees: if the business is incorporated, securing loans with a personal guarantee allows creditors to look beyond the corporate structure to the owner's personal assets for repayment.

Savings Accounts and Life Insurance Policies. Sometimes you can get a loan by assigning your savings account to the lender so that it can be used as collateral for a loan. In this scenario, the lender will keep your passbook and notify the savings account holder of the loan so the account will not be diminished during the term of the loan. Another form of collateral that follows this line of thinking is to use the cash value of a "whole life" insurance policy as collateral rather than borrowing directly from the insurance company. In that instance the policy is signed over to the lender until the note is repaid.

Stocks and Bonds. Stocks and bonds used as collateral must have a ready market. As a hedge against market fluctuations, lenders will usually advance no more than 75 percent of the market value of a high grade stock. If the value of the stock or bond declines, the borrower may need to provide additional security for the loan.

Endorsers, Co-makers and Guarantors. Borrowers often get other people to sign a note to bolster their own credit. If the borrower fails to pay up, the endorser must pay back the outstanding balance to the lender. Sometimes the endorser may be asked to pledge his or her assets or securities as additional collateral.

A co-maker is one who creates an obligation jointly with the borrower. In such cases, the lender can collect directly from either the original borrower or the co-maker.

A guarantor is one who guarantees payment of a loan by signing a guaranty commitment. Both private and government lenders often require personal guarantees from officers of corporations to insure loan repayment.

Assignment of Leases. An assigned lease as collateral is similar to a guarantee. The lender advances money on a building and takes a mortgage. Then the lease is assigned so the lender automatically receives the rent payments, which guarantee repayment of the loan.

Warehouse Receipts. Lenders will also take merchandise as collateral by lending money on a warehouse receipt. Such a receipt is usually delivered directly to the bank and shows the merchandise used as security has either been placed in a public warehouse or left on your premises under the control of a bonded employee. Loans of this type are generally made only on readily marketable goods.

Chattel Mortgages. If you borrow to buy fixtures or equipment and give the lender a lien on the equipment you are buying, you are making a chattel mortgage loan. The amount of the loan will likely be less than the purchase priceand this difference will be determined by the market value of the equipment and its rate of depreciation. You will be expected to have adequate fire, theft, liability, and property damage insurance on the equipment and to maintain it.

Real Estate. Real estate can be a form of collateral for long-term loans (see above). You will be required to maintain the property in good condition and carry adequate insurance on the property with the lender as beneficiary for the life of the loan.

SLIDE 9

HOW YOUR LOAN REQUEST WILL BE REVIEWED

A loan officer's primary concern when reviewing a loan request is whether or not the loan will be repaid. To help answer this question, many loan officers will order a copy of your business's credit report from a credit reporting agency. Their decision to lend you money depends upon their evaluation of your credit-worthiness using the 5 Cs of credit—character, capacity, collateral, conditions, and capital.

Character: Character means a borrower is honest, a good manager, experienced in business, and has a good reputation In other words, character is a collection of indicators that point to your willingness to make every possible effort to repay the loan.

Capacity: Will your business generate enough sales to repay the loan? Lenders will look not only at the business's financial projections, but also your personal ability to repay the loan if things do not work out as planned.

Collateral: In case the business is not successful or falls on hard times and the lender must foreclose, are you pledging collateral in an amount sufficient to cover the loan? The lender will use other factors to determine the worthiness of collateral to secure debt including determining whether the collateral is marketable and is it adequately insured. You can pledge personal assets like your home, vehicles, or stock shares as collateral for a business loan. But before you pledge these assets, think about the effects of losing them if the business fails.

Conditions: Market conditions include economic and demographic trends in the overall

business economy and your community, the seasonal character of your business, the nature of your product or service, and the amount of competition in your trade area. Your lender's experience with similar businesses will also influence their decision.

Capital: Lenders will not put money into a business unless they have evidence you have personally made a sizable financial commitment. They know from experience if the business turns sour, it will be easier for you to back out if you do not have your own money at risk.

PREPARING YOUR LOAN PACKAGE

Before you go to a lender, ask yourself some basic questions. Thinking through these questions and having the answers ready will lead to a more productive credit interview:

- What do you need the money for?
- What collateral do you have?
- How much do you need?
- When do you need it?
- How long will you need it?
- How will you repay it?
- Can you afford the interest?

The answers that you can provide for these questions are critical to the lender's decision. It is also important to prepare a loan proposal to provide the lender with as much pertinent information as possible. The information contained in your loan proposal should answer the preceding questions. The structure of a loan proposal contains these key elements:

Summary: This section should contain a brief description of the business and your contact information and will serve as the cover page to the proposal. You should include your name and title, the name(s) and title(s) of any business partners, the business name and address, the nature of the business, the amount sought, the purpose of the loan, the source of repayment, and the terms of repayment desired.

Depending on the type of loan you are seeking, you will be required to provide different types of information. For example, if you are seeking a guaranteed USDA loan you will have to have a feasibility study conducted by a third party, unbiased source. The SBA guaranteed loan program requires that an applicant have a business plan. Failure to have either one of these documents will hinder your efforts in acquiring a government backed loan.

Even commercial lenders will most likely require a potential borrower to have a business plan. This is a document that outlines the proposed business idea. It is important to create a clear and easy to follow business plan that thoroughly explains the business proposition. The business plan is a document that will allow a potential investor to gain a clear understanding of the business and how the necessary actions will be implemented to make it successful.

The basic requirements for a business plan are as follows:

Business Description: This section should contain all of the relevant information that describes the business. Examples of information that should be described include:

- The legal structure of the business. Is the business a sole proprietorship, partnership, corporation, or LLC?
- Years that the business has been in operation
- The number of employees in the business
- A detailed listing of the assets that the business currently holds and liabilities that the business currently owes
- If appropriate, include an evaluation of the business's inventory. Be sure to include a concise, but specific description of the inventory in terms of:
    - Size (level) of inventory currently held
    - The expected rate of turnover; and
    - The expected "saleability" of the inventory in case of rapid liquidation.
- If the business offers its customers credit, report the status of accounts receivable as well as accounts payable (what the business owes others).

Management Profiles: Develop a short statement describing the background and responsibilities of each individual directly involved in managing the business. Don't assume the potential lender knows this information, even if you have known each other for a significant length of time. Provide information on their background, education, experience, skills, area(s) of expertise, and accomplishments.

Market Projections: Clearly describe the product sold or service provided and the market(s) that you have targeted. Be sure to identify not only your customers, but also your competitors. Define the current share of the market that the business has captured, its growth opportunities, and plans for exploiting these opportunities over the next three to five years. You also need to identify any risk that is inherent in your growth plan and describe how you expect to deal with shortfalls if they occur.

Purpose: Describe how the borrowed funds will be used. Be aware that a request for the ambiguous "working capital" will raise questions, not money. Explain that the loan is to build up holiday inventory by increasing production starting in late summer or to replace your antiquated delivery van—whatever fits your situation.

Amount: Ask for the exact amount needed to achieve the business's objectives, and support these figures with estimates from suppliers, dealers, and others. Don't ask for too much, expecting the figure to be cut; or for too little, hoping a smaller request will be more likely to get approved. Bankers know costs, and they will be suspicious of any padding or shaving.

Repayment Plans: Describe how you will pay the loan back and the terms of repayment that you desire (interest rate, debt service schedule, etc.). Be aware that the potential lender will expect a financed asset to generate repayment funds through increased sales, decreased costs, or increased efficiency.

Financial Statements: If you are borrowing funds to expand an existing business, provide balance sheets and income statements or business tax returns for the past three years.

If you are just starting out, provide two sets of projected financial statements: one based on receiving the loan and the other going forward without it. Prepare a personal financial statement on yourself and the other owners of the business. List all the collateral you are willing to pledge as security for the loan.

Lenders expect the business owner to arrive with all required financial data. As bad as it is not to have the financial information they want, it is far worse to hide something that may damage the chances of getting the loan. Be candid. If there is some past mistake that is eating into profits, be sure to explain the mistake to the lender and describe the steps you have undertaken to make sure that the mistake doesn't happen in the future.

WHAT IF YOU'RE TURNED DOWN?

In many cases, despite all your efforts, your loan application will be denied. You still have a number of options. First, question the lender closely on the reason. If, for example, you asked for more than the lender thought your financials could support, file a new application for less money. The first rejection shouldn't affect your new application. But if you sense this lender really doesn't care about having your business, don't push it—go to a different lender.

Get the name of the loan officer at your new potential lender, make an appointment, and explain what happened with the first lender. Relate that you wanted $15,000, but that was more than your numbers supported. Explain that you have reanalyzed the data and have determined that you could accomplish your objectives with $10,000 but make it clear you are getting no help (receiving no funds) from the previous lender.

This will represent two things to the new loan officer. First, you will seem like a good prospect for a $10,000 loan. Second, the second lender will probably require you to shift all of your financial needs to his or her institution before granting the loan, so you will be a new, desirable customer.

ESTABLISHING AND MAINTAINING RAPPORT WITH YOUR LENDER

SLIDE 11

All business owners—whether their businesses are large or small, well-capitalized or operating on a shoestring—should develop a working relationship with their primary lenders. Taking advantage of opportunities and addressing challenges will require financial assistance, and the best hedge against a lender's loan rejection is to maintain a constant rapport. There are a number of steps a business owner can follow to do this; the following are offered as suggestions:

- Establish a credit history with the lender. Borrow funds for short periods and repay promptly.
- Find out what types of customers your lender is interested in serving. Is your business too large or too small? Most small businesses need lenders who understand their unique situations. It is more difficult to get the same level of attention from large financial institutions.
- Get to know the lender and its employees even if you do not need them now. Invite a potential lender to your business establishment or your primary place of business

activity. Introduce him or her to your employees. This will help him or her develop a well-rounded picture of your business and bring life to your financial statements.

- Keep your lender current on information concerning your business. Share your plans for the future.
- Apply for loans well in advance of the actual need for the money.
- Never surprise your lender! If you foresee repayment problems, tell him or her right away. He or she may have a solution and be prepared to help. Lenders would rather restructure loans for repayment than have to foreclose.
- Be honest with your lender, since the truth always comes out sooner or later.

REFERENCES

Boroson, W. (1987, June). The truth about home-equity loans. *Sylvia Porter's Personal Finance,* 46-54.

DuBoff, L.D. (1987). *The law (in plain English) for small businesses.* Seattle, WA: Madrona Publishers.

Dunlap, P. (1996). "The search for startup capital." Indiana Business Magazine, (Vol #22) pp. 51-54.

Financial assistance. (n.d.) *U.S. Small Business Administration.* Retrieved from http://www.sba.gov/about-sba-services/200/

Finkle, T.A. (1995). Financing options for small businesses. *NBDC Report,* 174, 3-4.

How to raise money for a small business: Focus on the facts. (n.d.). *U.S. Small Business Administration* Washington, DC: U.S. Government Printing Office.

Lastovica, A.M. & Gilmer, A. (1992). Sources of financing. *Virginia Cooperative Extension*, Publication 354-303.

McConnell, R.J. (1996). Business finance: State and federal financial assistance programs. *Indiana Small Business Reference Guide*, 14-18.

The facts about how to raise money for a small business. (1996). *U.S. Small Business Administration.* Washington, DC: U.S. Government Printing Office.

HANDOUT 1

MONEY NEEDS FOR THE FIRST THREE MONTHS

Living expenses

From last paycheck to opening day	_____
For three months after opening day (from cost-of-living budget)	_____

Deposits, payments, licenses required for the business

Telephone deposit for business line	_____
Sales tax deposit	_____
Business licenses	_____
Insurance premiums	_____

Household improvements

Remodeling and redecorating	_____
Fixtures, equipment, displays	_____
Installation labor	_____
Signs–outside and inside	_____
Landscaping, grounds improvement	_____

Inventory/supplies

Service, delivery equipment, and supplies	_____
Merchandise (approximately 65 percent in opening stock)	_____

Total operating expenses for three months	_____
Cash for petty cash, change, etc.	_____
TOTAL	_____

Money for living and business expenses for at least three months should be set aside in an interest-bearing account and should not be used for any other purpose. This is a cushion to help get through the start¬ing period with a minimum of worry. If expense money for a longer period can be provided, it will add to peace of mind and help the entrepreneur concentrate on building the business.

Prepared by Barbara R. Rowe, Ph.D., Family Resource Management Extension Specialist, Purdue University

HANDOUT 2

COST-OF-LIVING BUDGET

Regular monthly payments	
Rent or mortgage (including taxes)	$_____
Cars (including insurance)	_____
Appliances/TV	_____
Household improvements	_____
Credit cards	_____
Other	_____
Household operating expenses	
Telephone	$_____
Gas and electricity	_____
Water, garbage & sewer	_____
Repairs, maintenance	_____
Food expenses	
Food–at home	$_____
Food–away from home	_____
Personal expenses	
Clothing, cleaning, laundry	$_____
Doctors and dentists	_____
Pharmacy	_____
Education	_____
Dues	_____
Travel	_____
Gifts and contributions	_____
Newspapers, magazines, books	_____
Auto upkeep, gas, parking	_____
Spending money, allowances	_____
Tax expenses	
Federal and state income taxes	$_____
Personal property taxes	_____
Other taxes	_____
Budget summary	
Regular monthly payments	$_____
Household operating expenses	_____
Food expenses	_____
Personal expenses	_____
Tax expenses	_____
MONTHLY TOTAL	$_____

This budget is based on an average month. It does not cover the purchase of any new items except emergency replacements.

Prepared by Barbara R. Rowe, Ph.D., Family Resource Management Extension Specialist, Purdue University

HANDOUT 3

CASH-FLOW PROJECTIONS

	Start-up funds prior to loan	Month 1	Month 2	Month 3
Beginning Cash (cash on hand)				
1. Cash in bank				
2. Cash in investments				
3. Petty cash				
4. TOTAL BEGINNING CASH				
Income				
5. Cash Sales				
6. Credit sales payments				
7. Investment income				
8. Loans				
9. Other cash income				
10. TOTAL INCOME				
11. TOTAL CASH AND INCOME				
Expenses				
12. Inventory or new material cash purchases and payments				
13. Wages and Salaries (including owner's)				
14. Taxes				
15. Equipment expense				
16. Overhead				
17. Selling expense				
18. Transportation				
19. Loan repayment				
20. Other cash expenses				
21. TOTAL EXPENSES				
22. CASH FLOW EXCESS OR DEFICIT FOR THE MONTH (10-21)				

Prepared by Barbara R. Rowe, Ph.D., Family Resource Management Extension Specialist, Purdue University

HANDOUT 3

CASH-FLOW PROJECTIONS CONTINUED

Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	Total

