

## ***FINDING THE MONEY TO START***

There are a number of ways to finance the start up and operation of a small business and several of these are presented below. **However**, you must invest your own money & equipment into your own business to make other financing possible. Exhaust your own funds before you borrow from others. Lenders and investors require that you assume the bulk of the risk.

### **Do You Own Enough to Owe?**

Borrowing is possible but only if you own a sufficient amount of cash, inventory or equipment (assets) to provide reasonable equity for the loan. Investors and creditors evaluate the riskiness of a loan according to its “debt to equity ratio”. That is, what you *owe* compared to what you *own*. Different types of businesses have different target ratios but every type of business must demonstrate that they own enough to owe.

### **“Love Money”**

It is normal for entrepreneurs to get funds from family and friends. Remember to keep this relationship as business as possible. Prepare a written agreement detailing the loan **and** the proposed repayment plan. Inform them about your business progress and pay them back as soon as you can. Don’t let business destroy friendship or family.

### **Banks and Credit Unions**

If you think you may need money from a bank, plan this out as early as possible. Banks very often avoid investing in new businesses because they have no track record and 80% of new businesses fail within 5 years. You must present a *thorough* business plan; have a good personal credit rating and credit history (i.e. no bankruptcies, no credit cards at maximum levels, etc.) and sufficient collateral to secure the loan. You must be professional and precise with your presentation to your banker. Banks and Credit Unions also require that you have a minimum equity (or down payment) ranging from 30-50% of the total project costs.

Further, all lending institutions and most government assistance programs require “security” for any financing they provide. This includes any assets, personal and/or business which they can use as collateral to help secure the value of the loan and which they can seize and resell if the borrower defaults on his/her loan payments. The value of this security will directly impact the amount you can borrow. Some sample loan to value guidelines which financial institutions use are as follows:

Cash, Term Deposits, GIC’s, Bonds-	100%	RRSP’s-	0%
Personal and Commercial Property-	65-75%	Vehicles-	50-75%
Agricultural Equipment/Machinery	60-70%	Livestock-	60-75%
Accounts Receivable(current –90days)	75-50%	Business Equipment-	50-75%
Inventory-50% of cost (never primary security)		Plant Machinery	65%

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### **Leasing**

Instead of buying equipment or vehicles, consider leasing. This is easy on the business start up phase because it often requires little or no down payment.

### **Trade/Supplier Credit**

Find supplier who give you a month or more to pay for the goods and services you receive. Usually, you will have to demonstrate your ability to pay on delivery for awhile before getting a credit rating.

### **Credit Card**

A company credit card may be all much small service companies need to get over the periods of slow payment or inventory purchases. Keep it separate from your personal credit card and don't let it build up...they charge high interest. A credit card **should not** be used for major capital expenditures if there isn't sufficient income to pay it off quickly. They can provide short-term lines of credit, but are not a long-term solution to a cash crunch or cash flow shortage.

### **Government Assistance**

Governments no longer provide grants to operate or start up retail and service type businesses although there are a few special grant programs for manufacturing, processing and targeted individuals and it may pay to see if they can help your business. There are however a number of government loan and loan guarantee – which must be repaid and usually with interest.

**All** government programs require that you have a completed and detailed business plan that you contribute some equity (either cash or equipment) to the proposed business. Levels of equity and of government assistance vary from program to program, but it is essential that you have a clear idea of how much you need and how much you are contributing **before** you approach a government program.

## ***HOW DO INVESTORS/BANKS & GOVERNMENTS PROGRAMS DECIDE WHO GETS A LOAN?***

Most banks, credit unions and government programs base their process for reviewing loan applications on the **6 C's of Credit**.

**Credit** Your personal and/or business credit history and payment record. If you have a credit problem *bring it up anyway* because they will find out sooner or later.

**Collateral** The assets, which you can provide as security to guarantee repayment of the loan, their realistic value if they had to be sold off to pay the debt and if they are free from other liens.

**Character** Your personal characteristics such as your work history, letters of reference, management skills, time at your residence, effort at completing a business plan, commitment to endure running and operating a business.

**Capacity** How easy (or difficult) it is for you **and** your business to pay your debts. Typically, your personal debt should not exceed 40% of your total income. Further your business' cash flow must also demonstrate sufficient revenue and profit to make loan payments, pay operating expenses, wages, etc.

**Cash or** How much of your own money you are contributing.

**Capital** No one will lend you 100% of any project. Risk must be shared.

**Conditions** Any extraordinary or potentially detrimental conditions surrounding your personal or business situation (i.e. divorce, downturn in industry, environmental implications, etc.)

### ➤ **Financing Hint:**

If you get refused by a financier remember to ask why you have been refused in writing. Their response will help direct you to where your business, business plan or personal finances need improvement.

## ***WHAT TYPES OF LOAN “PACKAGES” ARE THERE?***

### **Term Loans**

These are the most common type of loans. They are given to provide funds for “hard”, long term assets such as equipment or property – usually the costly items. They are repaid over a set period of time (“loan terms” range from 6 months to 25 years). Interest rates can be fixed or change with the “prime” lending rate. Sometimes, interest only payments are made with the principle (amount of your loan) coming due at a specific date. Remember that most loans have *Demand Condition*... in other words, the loan must be repaid back “on demand” by the lender. Other conditions may be attached to the loan such as insurance on assets, life insurance, restrictions on disposing of assets and on borrowing additional financing, etc.

### **Line of Credit**

This is an operating loan designed to meet short term operating expenses such as inventory purchases, slow accounts receivable and initial advertising costs. They operate similar to credit cards with maximum borrowing amounts and a fluctuating loan balance. Your line of credit (sometimes called an *overdraft*) can continue providing you with these benefits long into the future. To get one you must provide a believable cash flow forecast and survive the “Six C’s” analysis. It is wise not to use this loan for investments that will only bring a return in the long term. (i.e. Renovating your premises).

### **Factoring of Accounts Receivable**

Factoring works for commercial customers on the same principle as credit cards for consumer customers. Large accounts receivable are “factored” or given to a financing or factoring company to collect and follow up on in return for a percentage of the total amount. Factoring allows companies, particularly in the manufacturing and processing to realize on their large accounts receivable, pay their suppliers immediately (perhaps for discounts) and prevent major cash flow shortages.