

# HOW TO FINANCE YOUR BUSINESS

**E**ven experienced small business owners have trouble obtaining a commercial loan for the first time. Here's some advice that could help you avoid problems and successfully finance your business.

## 1. DO YOUR HOMEWORK

Don't underestimate the importance of presenting yourself and your company in a positive light to prospective lenders. Determine exactly how much funding and what type of financing your business needs. The most common reason for a loan is to purchase assets.

- To cover the cost of short-term assets like current inventory, short-term debt—such as a line of credit—is typically used.
- To cover the cost of larger needs like expensive equipment or property, you'll need to turn to long-term debt—such as bonds or long-term loans that do not require payment in the near future.

## 2. RESEARCH YOUR FUNDING OPTIONS

There are two main types of business financing: debt and equity. Each offers some unique options.

### Debt:

- *Bank Loan:* Similar to loans you've taken on your home or vehicle, but harder to get. You will likely need to secure the loan with some type of collateral (such as your home or other property). Look for a bank that is active in small business financing; one that routinely makes your desirable loan size and is familiar with your industry and geographical area.

### Equity:

- *Private (or "Angel") Investor:* Instead of requiring collateral or repayment, private investors typically take an equity stake in your company and often expect to receive preferred equity security in exchange for their investment.
- *Venture Capital:* Similar to private investors, venture capitalists usually take an equity stake in your company and often expect to receive preferred equity security in exchange for their investment.

They often specialize in certain industries, and many provide corporate direction as well as financing.

- *Selling Stock:* Unless you have an ongoing business, you probably won't take your company public. Instead, you can do what is called a "private placement," where you sell shares of stock to a select group of equity investors. These investors then typically exercise control over the company in proportion to the number of shares they own.

## 3. PREPARE A BUSINESS PLAN

This is the most important step. An up-to-date business plan is necessary for prospective lenders to see detailed information about yourself and your company. Your plan should include:

- *An Executive Summary:* This should be very strong or potential investors may not read any further.
- *A Description of the Company:* Include what service or product you will provide, what will make you unique, etc.
- *Market Analysis:* Include the size of your potential market, how you will succeed against your competitors, etc.
- *An Overview of Your Operations:* Be specific.
- *A Marketing Plan:* How will you market your product?
- *A Description of Management Team and Staff:* Include background, experience and responsibilities.
- *Financial Statements and Projections:* Be realistic.

Finally, be prepared by reviewing your plan and financial statements with a professional, and be ready to answer any questions.

## 4. KNOW WHAT LENDERS LOOK FOR

Lenders will examine what is commonly referred to as the "five Cs" of credit while evaluating your loan request.



- *Character:* How you present yourself and your company.
- *Capacity:* Your ability to manage the business and successfully generate money necessary to repay the loan.
- *Capital:* Money you personally have invested in the business is a good indicator of your own confidence in the business.
- *Collateral:* The property you are asked to pledge protects the lender's interest.
- *Conditions:* The current economic climate and influences on the business.

## 5. GET YOUR FINANCIAL STATEMENTS IN ORDER

A prospective lender also will look at your financial statements provided in your business plan. Additionally, the lender will want to see:

- Personal financial statements for you and each partner or major stockholders,
- A balance sheet showing what the company owns and owes,
- A profit and loss statement; and
- Cash flow statements.

## 6. LOOK INTO ECONOMIC DEVELOPMENT PROGRAMS

Many federal, state and local government loan programs are available to small businesses. Local governments sometimes offer incentives such as tax breaks or discounted loan rates.

The federal Small Business Administration (SBA) provides management and financial assistance to small businesses. The SBA works with banks to guarantee a variety of loans for small businesses. If a bank turns you down, the SBA loan guarantee program is a possibility. Under this program, proceeds may be used for a variety of things, such as inventory acquisition or capital and debt restructuring. 

