What Lenders Look at to Approve you for Financing

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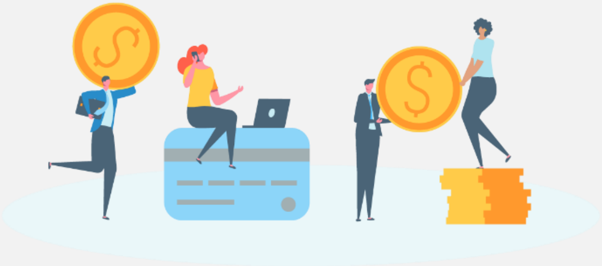
Business Financing

- It can be a challenge …
- … particularly for startup companies
- Lenders tend to be cautious
- They want to be sure you’ll pay them back



Business Lending

- There are **several options**
- These include:
  - Traditional lenders (usually banks)
  - Online lenders
  - Microlenders
  - The SBA

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What do Loan Applicants Need to Supply?

- Lenders generally want to see that you have:
  - Enough assets
  - Sufficient financial reserves and
  - Enough personal collateral …
- … to **ride out business fluctuations**

How do Loan Applicants Demonstrate These Things?

- Borrowers need to show a solid cash flow, sufficient to repay the loan
- They need to show a track record of profitability and
- They have to demonstrate success in a similar business endeavor
- Essentially, they have to prove their **creditworthiness**
- This isn't easy when you're just starting out

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How do Borrowers Prove their Creditworthiness?

- For startup entrepreneurs in particular …
- … they will need to demonstrate …
- … by using other means …
- … that they are **creditworthy business owners**

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How do Borrowers Prove their Creditworthiness?

- One way is to **prove they owned or managed a profitable business in a different industry**
- This means bringing in a resume and maybe financials from an earlier venture
- They may be able to show this if they can <u>supplement their own experience with that of someone who also has success in the field</u>
- This means bringing in a partner or maybe an angel investor as a mentor

Preparing to Meet with a Lender

- The borrower should have the following items:
  - A sound business plan
  - Any **financial information they can provide on their business**
  - Information on their personal credit
  - Often, also, <u>some means of securing the loan</u>

What goes into a Sound Traditional Business Plan?

- Industries vary, but traditional business plans all have similar components
- These are:
  - An executive summary
  - Description of the company
  - **Market analysis**

What goes into a Sound Traditional Business Plan?

- Business plans also include:
  - Data on the company's <u>organization and management</u>
  - A description of the service or product line
  - **Marketing and sales data** (startups won't have much in the way of sales data, but they should have a handle on how they're going to market their wares

What goes into a Sound Traditional Business Plan?

- Business plans also include:
  - The <u>company's actual funding request</u>
  - **Financial projections**
  - An appendix which includes all supporting documentation

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Startup Business Plans

- These are usually shorter than traditional plans
- They include information on key partnerships, activities, and resources
- The **value proposition**
- Customer relationships and segments

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Startup Business Plans

- They also include:
- Communications channels
- Cost structure and
- **Revenue streams**

Parts of a Traditional Business Plan

- Executive summary – a brief **overview of your company**, product, executive team, and future plans for growth
- Company description – get into detail about your company's niche and the problems it solves
- Market analysis – <u>how can you do better than your competition?</u>

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Parts of a Traditional Business Plan

- Company organization and management – what's your business entity and who does what?
- Service or Product Line – not only what you sell, but also **future plans or even patents**
- Marketing and sales data – what are your strategies to attract and retain customers?

Parts of a Traditional Business Plan

- The company’s actual funding request – itemize and clearly show how you are looking to spend the funds
- Financial projections – include income statements and the like if the company is already established. If not, this is a place to list **potential collateral**
- An appendix – here’s where to add licenses, permits, and patents and the like

Parts of a Startup Business Plan

- Key partnerships – which suppliers and manufacturers will you work with?
- Key activities – **how will your company gain a competitive advantage**?
- Key resources – which resources will you leverage to <u>give your customers value</u>? These can include:
  - Personnel
  - Intellectual property
  - Capital

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Parts of a Startup Business Plan

- Value proposition – which **unique value** will your product or service bring to the market?
- Customer relationships – what will the customer experience be like? In person? Online? Something else?
- Customer segments – who will your business serve? Do you have a good handle on what your ideal customer (AKA buyer persona) is really like?

Parts of a Startup Business Plan

- Communications channels – how will you speak with your customers? How will you **optimize communications in the future**?
- Cost structure – will you be trying to maximize value or reduce cost? Regardless of strategy, how much is that going to cost?
- Revenue streams – how will your venture actually make money? Direct sales? Memberships or subscriptions? Selling ad space? Something else?

Financial Information on a Business

- Apart from the business plan and its contents …
- You will need a P & L
- That's a **profit and loss statement**

Profit and Loss Statement

- A P&L is, according to Investopedia:
- *"… [A] financial statement that **summarizes the revenues, costs and expenses** incurred during a specific period of time, usually a fiscal quarter or year. These records provide information about a company's ability – or lack thereof – to generate profit by increasing revenue, reducing costs, or both. The P&L statement is also referred to as 'statement of profit and loss', 'income statement,' 'statement of operations,' 'statement of financial results,' and 'income and expense statement.'"*
- See: https://www.investopedia.com/terms/p/plstatement.asp

Profit and Loss Statement

- The P&L (AKA the income statement), one of three quarterly and annual statements a company makes as to its financial health. The other two are:
  - The cash flow statement
  - The balance sheet
- There are numerous **blank P&L forms are online** to help you

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What does a P&L show?

- The idea is to **show changes in accounts**
- This is over a specific time frame
- In that way, it’s similar to your cash flow statement
- This is not like a balance sheet, which is more of a snapshot

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What does a P&L show?

- A P & L will give you a handle on the money your business has
- You know **how much capital is coming in** …
- … <u>and going out</u>
- It’s good for more than just yet another piece of paper to give to a lender

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Monthly and Annual Revenues

- Online lenders in particular want this data
- It shows not only what your company makes …
- … but also any **trends** …
- … or even <u>seasonality</u>

Bank Balances

- Online and offline lenders want this data
- It helps to show not only trends …
- … but also <u>responsible money management</u>
- It’s also **another way of showing seasonality**

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The Power of Knowing Your Numbers

- The power of knowing your numbers is vital to running any profitable business
- You can make any necessary adjustments to show a profit
- **Numbers do not lie** to you!
- They tell everything about the health of a business

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The Power of Knowing Your Numbers

- Knowing your numbers means you have a **huge advantage** over business owners who do not
- Your profit and loss statement tells a <u>story of your unique business</u>
- Understanding the story behind your numbers can be an extremely important factor for achieving success

Personal Credit Information

- Lenders will often want to see your FICO score
- This is particularly the case for:
  - Sole proprietorships and/or
  - Startup companies
- They want to know if you're experienced in **paying back loans** …
- … <u>or if you default</u> on your obligations

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Time in Business Information

- For online lenders in particular, time in business matters
- Of course a startup has no time in business
- But other ventures do
- Because so **many businesses fail in their first year** …
- … creditors want to know this

Means of Securing the Loan

- Lenders are often looking for a means of securing the loan
- **This protects them in case you default** on your obligations
- Fortunately, collateral and other means of securing loans can be done creatively

Collateral-based loans

- Use your assets as collateral
- **Rates are often 5% or less**
- Your <u>personal credit rating will not matter</u>

Some of the Types of Collateral You Can Use

- Your 401(k)
- Stocks
- Existing **inventory**
- Accounts receivable

Or Ask a Friend or Family Member with These Kinds of Assets

- They may let you leverage their asset in exchange for a % of your business
- They usually want less of a % of your company than a VC would
- Essentially, they would be acting **like an angel investor**
- It's a bonus if they can mentor you in business

401(k) Financing

- Use existing 401(k) or IRA as collateral for business financing
- Pay **no tax penalties**
- You still earn interest on your 401(k)
- Low rates, often less than 5%
- Close and fund in less than 3 weeks
- Can usually get up to 100% of what’s “rollable” within your 401(k)

Securities-Based Financing

- Use your existing stocks as **leverage to get business financing**
- Borrow as much as 90% of the value of your stocks
- You keep earning interest on the stocks pledged as collateral
- Closing and funding takes less than 3 weeks

Securities-Based Financing

- 70 – 90% loan to value
- Rates are like mortgage rates
- **5% is common…**
- … but you **only** pay interest on what you borrow
- This is a working capital line of credit
- Challenged personal credit

Inventory Financing

- Use your existing inventory as collateral for business financing
- You will need inventory valued at $500,000 or more
- You can get approved for a line of credit for 50% of inventory value
- Rates are usually 5 – 15% depending on type of inventory
- Funding within **3 weeks or less**

Inventory Financing

- Minimum inventory loan amount: $150,000
- General loan to value (cost) is 50%
- So **inventory value needs to be $300,000 or more**
- It <u>can’t be lumped together inventory</u>, like office equipment

Accounts Receivable Financing

- Use your outstanding account receivables for financing
- Get **as much as 80% of your receivables** advanced ongoing in less than 24 hours
- Remainder of the accounts receivable is released once the invoice is paid in full
- Closing takes <u>2 weeks or less</u>

Accounts Receivable Financing

- Factor rates **as low as 1.33%**
- It is a credit line with rates of less than 1% with <u>no consumer credit requirement</u>
- Receivables should be with the government or another business
- If you also have purchase orders, you can get financing to have those filled
- You won't need to use your cash flow to do so

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Accounts Receivable Financing

- Get forwarded up to 80% of receivables
- You have to be in business for one year
- These **must be receivables from another business**
- Rates of 1.25-5%

Other Collateral Options

- Other collateral options include your company's equipment
- You can also use invoice factoring
- Invoice factoring is <u>not quite a loan</u>
- Instead, you essentially **'sell' your outstanding invoices to a factoring company** …
- … and they collect directly from your customers

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Personal Guarantees

- Another option is the personal guarantee
- It's exactly what it sounds like
- Your **personal assets are at stake**
- But sometimes, particularly for startups, you'll have to give one

Microloans

- Microloans are another option
- You **can't get a microloan from a regular lender**
- Instead, you get a microloan from a microlender
- Try the Association for Enterprise Opportunity to find a local microlender
- http://www.microenterpriseworks.org/

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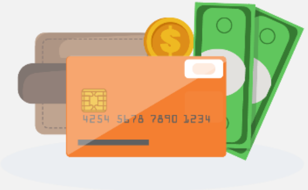
SBA

- SBA loans are another option
- You usually need to show some **time in business** for SBA loans
- The most popular SBA loan for working capital is the 7(a)
- Approvals for <u>up to 5 million</u>
- Rates are usually 2-4% above prime rate
- All owners with more than 20% ownership must provide a personal guarantee
- Good consumer credit is required

Recap for What Lenders Look at to Approve You For Financing

- Lenders want to be sure a company can pay back its obligations
- They **want to know your business is a going concern**
- They want to see if it is succeeding, or if it should be
- Borrowers need to prove their <u>creditworthiness</u>



Recap for What Lenders Look at to Approve You For Financing

- **Documentation is crucial**
- Virtually every lender wants to see a business plan
- Business plans can be traditional or for startups – and these have different sections
- Lenders also want a P & L
- They usually also want some sort of collateral or personal guarantee