Financing Options for Your Small Business

Show me the money!
Purpose:

Commercial Financing Basics

Potential Methods of Commercial Finance

Overview of U.S. Small Business Administration
Key Lending Programs

Quick overview of Alternative & Creative Lending Resources
Topics to be discussed:

5 C’s of credit
Family, Friendly Funding

Business Plans
LLC’s & Partnerships

What to take to the Bank
Selling equity / shares

SBA Loan Guaranty Program
Venture Capital

Microloans
Angel Investors

Self Financing
Crowd Funding
5 C’s of credit

- Character
- Capacity
- Collateral
- Conditions
- Capital
5 C’s of Credit

Character:
- the trustworthiness of candidates for character.
  Factors are: business experience, credit history, references, and education, experience (aka Business Résumé)

Capacity:
- the business and guarantors' ability to repay the loan.
  Capacity is a derivative of Cash Flow and Margin.
  
  - management capacity is also a key factor.
    Does the owner/operator possess the management skills to successfully operate the business?

Collateral:
- various forms of assets can act as another method of repayment.
  Collateral could include: equipment, real estate, inventory, accounts receivable, and securities.
Conditions:
- a review of the small business credit or loan conditions in terms of use verses consumer activity
- also applies to the external environment that impact a company's ability for repayment (NAICS code)

Capital:
- business owner's investment into their own company
- a business owner unwilling to invest their own funds in the company will often find banks are unwilling to take the first risk

Each of the five C’s are reviewed by lenders / investors for determining credit / financing terms
#1 Challenge

The LACK of the usual 30% – 40% CAPITAL / CASH requested by lenders for start-ups
One of the most important tasks to obtain a small business loan is preparing a business plan.

The business plan needs to show the lender that providing you with a small business loan is a mitigated, low-risk proposition.

Your business plan must answer the questions a lending institution would ask…
Why do you need the money?

How much money do you need?
- If you are starting a business, this should be included at least in the start-up capital estimate. Accuracy is important, so request enough money to invest wisely.

What are you going to do with the money?
- You will have to provide, in detail, the designated use of every dollar requested.
- A small business loan is often needed for: operations (new employees, marketing, etc.), assets (equipment, real estate, etc.), or to refinance current business debt.
When will you repay the small business loan?
- You will need to convince the lender (with your financial statements and cash flow projections) that you are able to repay the loan through projected long-term profitability of your business.

What will you do if you don't get the loan?
- Let lenders know that rejection will not discourage you from starting or growing your business.
- As a small business owner, you will need a certain degree of fortitude.
- Ask the lender why you didn't get the small business loan. Learn from the answer, move on, and try other lenders.
What to take to the bank

Common documentation includes:

- Purpose of loan
- Business history*
- 3 years of business financial statements*
- Schedule of term debts*
- Aging of accounts receivable and payable*
- Projected opening-day balance sheet**
- Copy of Lease(s) and / or liens
- Amount of owner investment in business
- Projections of income, expenses & cash flow
- Signed personal financial statements
- Guarantor Business Résumés

* for existing businesses    **for new businesses
SBA Loan Guaranty Program

- 10 different loan programs
- 1 microloan program
- Up to $5 million loan amount
- For start-up & existing businesses
SBA does not provide:

- Grants
- 100% financing
- Funding for Illegal Enterprise (Federal)
- Gambling
- Pass Throughs nor Speculatives
- Prurient Nature Industries
- Direct business loans (except for Nationally Declared Disasters)
- Non-Profits
How does this process work?

• **Step 1** – Work with SBA and our resource partners to develop a finalized business plan

• **Step 2** – Visit your current lending institution to discuss financing options

• **Step 3** – Lender decides to utilize a traditional loan or seek an SBA guarantee

• **Step 4** - Lender submits request to obtain SBA guarantee

• **Step 5** – If approved, lender works with you on loan closing
7(a) loan guarantees

- Loan Amounts up to $5M
- 50-90% loan guarantees - Typically 75%
- Upfront Guaranty Fees waived up to $150K
- Long Term Financing
  * Working capital up to 10 years
  * Equipment Purchase up to 10 years or useful life if longer than 10 years
  * Commercial Real Estate up to 25 years
- Rates: Prime + 2.25% (<7 yrs) to Prime + 4.75%
  accessed at any participating bank
504 Loan Guaranty Program:

- Long-term, fixed-rate financing (10 & 20 year terms)
- 50/10/40 Split between Bank, Borrower and Certified Development Company (CDC)*
- Fixed Assets Only
- Commercial Real Estate
- Less risk for primary lender
- Lower equity requirement for borrower

* 10% for Existing Business, 15% for S/U and 20% for Single Purpose Facility
Micro-Loans

- SBA provides loans through non-profit intermediary
- Micro-lender loans of up to $50,000 to small businesses
- Maturity up to six years
- Interest Rates typically range 8 to 13%
- Technical assistance provided

Micro-Loans can be Used for:
- Machinery, equipment & fixtures
- Leasehold improvements
- Inventory
- Working capital
Personal Finances Can Affect Your Business Finances (check your personal credit history)

Starting a business can be a tremendous strain on your personal finances

It takes time before your new venture turns a profit and provides financial support

Before starting a business, get your personal finances in order

Write a monthly household budget
1. Don’t be afraid to ask
Practice your “elevator pitch,” and end it by asking for the order.

2. Be passionate about the idea
You are your best marketer!

3. Demonstrate progress and your own “skin in the game”
What would convince you to invest in someone else’s idea?

4. Communicate the risks
Be honest about the inherent risks of a startup.

5. Write down the agreement
Get your agreement in writing with witness signatures and respective ‘originals.’
Startup Cost / Control / and Ease of Operations are characteristics of these forms of business.

**General Partnerships:** Requires two or more people who have joint and several liability in the partnership. They must file an assumed name statement a/k/a dba with the county clerk in the county where your main operations occur. The fee in most Texas counties are under $30.00

- *What about a partnership agreement?*

**LLCs:** File with the Secretary of State – Limited formalities – Owners are called “Members”. Filing fee in Texas is $300.00

*It is highly recommended that you seek legal counsel when forming these entities.*
Limited Partnerships & Limited Liability Partnerships

Key Characteristics:

• **Limited Partnership (LP):** Requires the joining of two or more people, but there must be at least one general partner. General Partners bear full responsibility for the entity.

• **Limited Liability Partnerships:** While similar to LPs all partners enjoy limited liability for the debts and obligations of the partnership.

• **Expensive to form in Texas** - All partners enjoy limited liability for the debts and obligations of the LLP and from the other partners. LPs must register with the Texas State Comptroller of Public Accounts for a fee of $750.00. Limited Liability Partnerships register with the Secretary of State for $300.00 plus pay an extra amount for each partner.

*It is highly recommended that you seek legal counsel when forming these entities.*
Partnerships & LLCs (cont’d)

• **Pooled & Leveraged Resources** - Limited partners can be passive members of LLCs and useful for pooling resources to secure credit and raise capital. Partners can also complement each other's skill sets. Limited Partners are limited in liability to the extent of their investment.

• **Profit Sharing** - The operating agreement outlines profit and loss sharing among partners who receive a share of profits.

**Taxation** - LLCs are subject to pass-through taxation. While the business files an informational tax return with the IRS, individual partners, both general and limited partners, pay the LP's taxes respectively.
Corporations

- C – Corporations
- Subchapter S
- PC
- Shares/stock represent ownership in a company

- You can sell shares of your company to raise capital or sell your business outright.

- Prepare a valuation report on your business to determine how the worth of your company shares. This will require a specialized accountant.

- Explore different options for selling your shares. Much will depend on the size of your business: If you have a start-up company, the best option for you may be angel investors or venture capital firms (discussed later).
- For established companies, you can sell shares through private placements or get a public listing on an organized stock exchange.

- Approach potential investors to sell shares to the highest bidder.

- Do not sell shares below estimated worth. If no reasonable price appears, postpone your sale of shares to a later period.
Go to:

• **Business.Gov** -

• **Texas Secretary of State**
  [www.sos.state.tx.us](http://www.sos.state.tx.us) - Business Start up information.
• Generally not the initial capital raising stage

• Typically “equity” investment

• VC is often given a board seat or holds some management influence

• Exit strategy in place, usually after five years

• Innovation & Inventions often targeted

• Seek high earnings growth
SBA has the largest Venture Capital program Operation in the world:

The

Small Business Investment Company (SBIC) program.

For more information go to:

- [www.sba.gov](http://www.sba.gov) click on SBIC
Angel Investors

• Informal group of Investing Group

• Angels often have target industries

• Must have the potential for fast growth; not necessarily high-tech

• Very early stage

• Equity financing
4 Basic Methods of Crowd Funding

• **Reward Based** – for non monetary benefits

• **Donation Based** – for philanthropy or sponsorship (taxable earnings write off)

• **Equity Based** – includes revenue and profit-sharing models

• **Debt Based** – P2P lending, P2B lending and social lending
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