How To Find FINANCING For Your Business

One of the most difficult tasks faced by the management team of small businesses today is finding adequate financing for current operations in order to support new and ongoing contracts. The sources for financing your business are many, but the type of financing you may choose are limited to two types. They are debt (borrowing money) or equity (investing money). Both types of financing have their limitations and advantages but both require accurate information. The applicant should be prepared to answer the following questions when seeking either debt or equity financing:

Publication 37
August 1996

Debt Financing
Borrowing Money

- What collateral is available to secure the loan?

- What assurances can be offered to the lender as to the company's ability to meet its debt-service obligations (how will it be repaid)?

- What additional financial risks and/or failure will be placed on the corporation as a result of these debt-service obligations?

- What are the direct (principal and interest) and indirect (other loan restrictions) costs of this additional money?

Financing Documents Checklist

- ✓ **Copy of company's Articles of Incorporation**
- ✓ **Corporate Tax Returns - copies of past 3 years filings**
- ✓ **Previous 3 years Financial Statements**
- ✓ **Current year interim Financial Statement**
- ✓ **Company history, capabilities and marketing information (or Business Plan)**
- ✓ **Accounts Payable Aging Report**
- ✓ **Accounts Receivable Aging Report**

Equity Financing
Investment Money

- What will equity holders suffer or lose as a result of getting additional equity capital?

- What are the relative risks involved in the use of the capital to be raised? How will prospective investors assess this risk in determining their expected rates of return?

- What are the projected profits to be generated by the use of the capital to be raised? How and when will these profits be divided and distributed among the holders of the company's equity securities?

- What tax advantages are lost as a result of the choice of debt (borrowing money) over equity (investing money)?

The management team must prepare and submit to the bank or financing company minimally the following eight (8) essential elements that describe your business:

I. Business Description

- Describe the business, its products, and customers
- Identify who owns the business and what qualifications they have to run the business
- Describe addition of key management and operational personnel
- Describe previous financing

II. Market Analysis

- Repeat customers and significant large customers
- Valuable trademarks or traditional images
- Methods of distribution
- Seasonality patterns
- Spending levels by major customer group
- Size of the market in 5 years and 10 years
- Impact of new technology on market size
- Major competitors in terms of identity, location, and market strength
- How competitor products and services compare to your business
- The strengths and weaknesses of the major competitors
- Any proprietary assets such as copyrights, patents, and trademarks
- Define any important regulatory requirements by the FCC, EPA, FDA, SEC

III. Marketing Strategy

- Define target markets by product line niche and by major customer
- Describe major pricing, quality control, and market share decisions
- Identify sources of revenue growth
- Describe key factors of demographic trends and locations
- Provide sales plan and advertising plan

IV. Operations

- Location facilities
- Terms of any leases or mortgages on real property
- Any expansion plans in terms of new facilities
- Corporate and administrative overhead, and fixed and variable operating costs
- Status of standard cost or job cost systems
- Strengths and weaknesses of receiving and warehousing functions
- Inventory reporting methodologies, including physical inventory methods
- Status of labor relations, including legal and union environment
- Market costs and competitive factors impact on the labor force

V. Organization / Management

- Provide a detailed organizational chart by department and region
- Describe key managerial talent
  - Duties and responsibilities
  - Significant achievements
  - Professional resumes
  - Compensation and ownership incentives
  - Terms of employment contracts
  - Any related party transactions
- Describe the members of the Board of Directors or Trustees
  - Professional credentials
  - Committee membership
  - Responsibilities

FINANCIAL RESOURCES LISTED ON BACK PAGE

VI. Scheduled Major Events

- Provide a timetable of major events expected within the next 3 to 5 years
- Describe new openings, products, and services
- Describe necessary capital expenditures
- Describe preliminary merger, acquisition, spin-off, or IPO (Initial Public Offering) plans

VII. Financial Information

- Provide historical financial statements for the past five years:
  - Income statements
  - Balance sheets
  - Statements of cash flows
  - Copies of income tax returns for last 3 years
- Provide sales detail (with copies of contracts from customer) by:
  - Location and product line;
  - Specific products or services
  - Size of transaction
  - Major customer
- Prepare five year financial projections
- Describe all assumptions underlying the projections and discuss risk of unforeseen events
- Prepare historical monthly financial statements for the past two years
- Prepare projected monthly financial statements for the next two years
- Prepare a detailed break-even analysis

VIII. Financing Objectives

- The need for financing, size & type required
- Be prepared to have a plan to explain how you will repay the money borrowed.

Where To Go For Financing

- **SBA,** (202)205-6510 or fax (202)205-6959 for the Directory of Operating Small Business Investment Companies. www.sbaonline.sba.gov

- **AT&T Small Business Lending Corporation,** (800)221-7252 for reference to an office near your business. www.att.com/capital/bfnet

- **Business Consortium Fund,** (212)243-7360

- **National Association of Investment Companies,** (202)289-4336

- **SBA** for list of Small Business Development Centers in your local area.

- **Alternative Financial Services, Inc.,** (703)370-1599 or 1(800)480-1599. For information about contract and purchase order financing, fax to (703)751-1707. This company finances federal, state, city, and high grade commercial contracts and purchase orders for small businesses. http://www.dirs.com/finance/ALT

- Often overlooked for referral sources to financing are: relatives, friends, CPA's, law firms, local or state chamber of commerce, local economic development authorities, and elected federal and state official's offices. Attendance at seminars, workshops, conventions, and professional membership events are very productive because banks and financial institutions are always present advertising their services.

Sources Of Financing

- **Private Individual Investors** - The private placement generally offers reduced costs because of its exemption from many of the extensive registration and reporting requirements imposed by federal and state securities laws. The private placement alternative usually also offers the ability to structure a more complex and confidential transaction, since the offerees will typically be a smaller number of sophisticated investors.

Sources Of Financing

- **Institutional Venture Capital** - The term "venture capital" refers generally to the early stage financing of young, emerging growth companies at a relatively high risk. The professional venture capitalists are usually a group of highly trained general partners who manage a pool of venture funds for investment in growing companies on behalf of a group of passive limited partners or a federally licensed Small Business Investment Company (SBIC).

- **Commercial Finance Companies** - Many companies who seek debt financing but are rejected by banks turn to commercial finance companies, factoring companies, and accounts receivable financing companies for credit. These companies usually offer debt financing at considerably higher rates than an institutional lender, but are often willing to provide lower rates if the company takes advantage of other services offered for fees, such as payroll and accounts receivable management. In part, due to fewer federal and state regulations, commercial finance companies generally have more flexible lending policies than traditional commercial banks.

- **Leasing Companies** - Small businesses with a need to acquire specific assets to finance their development should consider leasing as one alternative to debt financing. Leasing typically takes on one of three forms:

    - **Sales and Leaseback Arrangements** under which the company sells the asset to a third party and then immediately leases it back from the third party for a specified period and under specific terms. The advantage here for the seller/lessee is that the funds which would otherwise be used to pay the sale price of the asset remains available for other purposes, the use of the asset is retained and the lease payments generally qualify as deductible business expenses;
    - **Operating Leases** usually provide the lessee with both the asset and a service contract over a period of time which is generally less than the actual useful life of the asset. As a result, the aggregate payments under the lease contract are not sufficient to recover the full value of the equipment which usually means lower

monthly payments for the lessee. If negotiated properly, the operating lease will contain a cancellation clause which gives the lessee the right to cancel the lease with little or no penalty and;

- **Capital Leases** differ from an operating lease in that they generally do not include any maintenance services and involve the use of the equipment by the lessee over the full useful life of the asset.

- **State and Local Government Programs** - Many state and local governments provide direct or indirect financing to small and growing companies in an effort to foster economic development. The amount and terms of the financing will usually be regulated by the statues authorizing the creation of the state or local development agency.

- **Trade Credit/Consortiums (Vendors and Customers)** - Suppliers have a vested interest in the long term growth and development of their customer base and may be willing to extend favorable trade credit terms or even direct financing to help a customer's growth. The same principles apply to the customers of a growing company who rely upon the company as a key supplier of needed resources. A new trend is emerging in customer related financing, known as a consortium.

- **Credit Card Financing** - Another new and emerging source of contract financing is the credit card facility which is being used by the federal government, particularly the General Services Administration for its purchase order business.

Summary

- This is a very short explanation of the documents you will need to submit a request for financing. The amount and nature of information will vary with each financing source; therefore, be prepared to provide more information than stated in the financing checklist. Remember, every financing source has its own document requirements.