

STARTING A NEW BUSINESS WITH A BANK LOAN OR INVESTORS

How much money would you need, from other than your own resources to start your business? Without a comprehensive **Business Plan** *you literally have no idea how much money you will require!*

Before you start your plan; **consider the current reality on seeking financial assistance** for your new business start-up during a nationwide financial recession!

The bank's loan officer will check your credit history before you ever sit down to talk!

When did you last check your credit records? Do this at least annually, whether or not you need a loan! If it is wrong then it must be corrected to truly reflect your ability to handle credit and debt. Do it now before you move forward with your business intentions. This may take some time and effort on your part! Go to:

http://www.sba.gov/smallbusinessplanner/start/financestartup/SERV_BORROW.html

Background on the bank loan officer's point of view

- If **your credit score** is weak, poor or worse, *do not expect any loans or professional investor support.* If your credit score is “good enough”, and based on other factors, you may be offered a loan at a significantly higher rate of interest to cover the bank's risk. If your credit score is “very good” you may qualify for the bank's lower or lowest business loan rates. Interest rates vary based on the risk of your loan for the bank.
- Your **personal management experience** with operating a business which you expect to start. If you have no relevant experience; who will you hire to run this business for you?
- Your **owner's equity** contribution to your total financial start-up requirement as specified and defined in your Business Plan. You will be expected to provide 20% or more of all the money your Business Plan projects as a total requirement to start and operate your new business. If you cannot do this you will find it difficult to get a loan!
- Your proposed **collateral** of personal or business assets whose *discounted value* will equal or exceed the value of the loan! Discounted value is the price which the bank might reasonably expect from the sale of your assets to recover their money if you default on their loan. This is NOT the price you paid for your assets! In most cases, this value will always be lower than your cost!
- Your **Business Plan**. Is it detailed and comprehensive and does it confidently predict financial success? Is it based on documented market and financial analysis? Does it project not just profitability, but also adequate monthly positive cash flow to ensure your ability to stay in business, pay off your loan and pay yourself an amount adequate to your personal needs? Finally, will your business also require a line of credit, beyond your up-front loan, in order to operate?

Banks minimize their risks by carefully checking three things in this order:

- The potential borrower's personal and business **Credit History**. If a potential borrower is aware that their credit history is weak, or that they have ever been personally bankrupt, they may reasonably be assured they have a very small chance of receiving a business loan; especially in today's guarded credit climate. The SBA generally will not (cannot) intercede to help a potential borrower repair their poor credit history.
- The potential borrower's proposed **Collateral Coverage Ratio**, or Total Discounted Collateral Value, divided by the Total Loan Value. Simply; banks will demand that their risk is fully and safely mitigated by the discounted collateral value of the borrower's proffered business and total assets. The borrower with insufficient collateral can, of course, seek a friend or relative who will co-sign the loan and sign over their personal and business assets as collateral for the borrower's loan. This is analogous to parents co-signing their child's student loan by offering their family's assets as collateral.
- The degree of detail in a borrower's **Business Plan**. Does the BP define the Borrower's business experience, in detail, and is it relevant to this proposed business. If not, who will run this business? Banks will generally not fund on-the-job management training for a new business owner in today's economic climate. Does the BP display sufficient market research and draw appropriate and positive operational and profitability conclusions to merit entering this marketplace? Are the financial projections comprehensive and backed by sufficient and documented research on all expenses and projected revenue streams and does it consider monthly cash flow as well as annualized profit and loss displays. Can the Borrower "sell" his BP's contents knowledgeably and confidently?

In "selling" his BP the borrower will need to convince the loan officer that the loan and associated interest and fees can and will be paid off in full. The Bank will expect the borrower to make three basic personal contributions to his own business:

- The business loan borrower must provide **owner's equity** with a personal investment of a minimum of 30% of all the money projected to be needed to start and initially operate a new business. The remaining 70% is the value of the loan sought. Consider owner's equity as earnest money which indicates to a bank that the borrower is committed to success.
- The borrower will be required to legally bind over **collateral** of business or personal assets to the bank, equal to or greater in *discounted value*, than the total amount of the loan, plus all interest and fees. "Discounted value" is the reasonable selling price of the assets, plus expenses of selling, and NOT the original purchase cost of the borrower's assets. Think of the resale value of a brand new car the minute it is driven off of the dealer's lot and transforms into a "used car"!
- The borrower must present a **Business Plan** with a convincingly detailed projection of sufficient cash flow to cover the loan repayments, plus all business operations, payrolls and tax obligations and finally, to generate sufficient profit to make the business successful for the borrower.

Role of the SBA:

- **The SBA does not lend money** and they cannot help you get a bank loan if you have a poor lifetime personal or business credit history! The SBA cannot help you change your credit history or score. SCORE cannot help you fix or change your credit history or your score. Only you can do this; and then only if it is fundamentally incorrect, and you should plan on a long time delay and lots of effort on your part.
- If you have good-to-excellent credit scores, here is what the SBA MIGHT DO and this is a significant level of assistance. If the SBA and the bank by separate and careful

consideration of your written Business Plan; each believe your plan is a prudent credit risk, then **SBA will work with the bank to act as guarantor of some or all of the collateral** you may be required to provide the lender to support your loan to start your business. In some cases, they might work with the banks, on your behalf, for reduced requirements for up-front owner's equity contributions to your total start-up costs as well.

SANDHILLS SCORE CAN HELP YOU

Once you have established that you have a good credit history, Sandhills SCORE can help you to prepare a **Business Plan**. This plan structures your detailed understanding of how you will start-up and operate a new business and how much start-up and initial operation funding will be required. You will need to understand and **SELL** your business concept and probability of profitability to bankers or investors in significant detail. We can help you understand and develop the contents, and uses of each of the elements of a comprehensive Business Plan.

Further, you will need this Business Plan to fully develop, for yourself, what facilities, employees, inventory and business machinery and equipment and marketing methods you will need and what it will cost YOU (in cash or debt) to start and operate your business, and build up clientele for your new business in your chosen marketplace.

Once this detailed business planning absolutely convinces you that you can make a profit, with your product or service, in your projected marketplace, you will be ready to convince a banker or investor and the SBA. Sandhills SCORE can assist you as well in understanding the loan SUPPORT programs of the SBA and how the SBA can work with your banker to develop the requirements for your loan package and reduce the personal burden of your bank loan.

Finally, remember...you will need a Business Plan to be successful whether or not you need a loan !!