Access to Capital

What You Should Know BEFORE You Apply for a Small Business Loan

Wacif

About Wacif

- The Washington Area Community Investment Fund (Wacif) is a Community Development Financial Institute (CDFI) and nonprofit loan fund based in Washington, D.C.
- Since 1987, Wacif has empowered underserved communities in the Washington, D.C. metropolitan area by providing access to capital and expertise to entrepreneurs and community organizations.
- Our mission is to build inclusive entrepreneurial ecosystems, pursue equitable economic development, and support community wealth building through our investment activities to strengthen our region's economies and communities.

Wacif

Workshop Overview & Goals

Learn about:

- 5 Stages of Business Growth & Financing Needs and Options
- 5 C's of Credit
- What the Lender Wants to Know: Assessing the Financial Health of Your Small Business
- Personal Credit & Borrowing Capacity

5 Stages of Business –
Adapted from the Harvard Business Review

Stage 1. Existence (a.k.a. "Start Up")

- The main concerns of the business are **obtaining customers** and **delivering contracted product and/or service**.
  - Does the business have **enough money to cover** the considerable cash demands of this **start-up** phase?

Stage 2. Survival ("Cost of Staying in Business")

- The business has demonstrated that it is a workable business entity. The main concern **shifts from mere existence to the relationship between revenues and expenses**.
  - Can we, at a minimum, ***generate enough cash flow to*** stay in business ***and to finance growth*** to a size that is sufficiently large, given our industry and market niche, to ***earn an economic return on our assets and labor***?

Courtesy: Harvard Business Review: The Five Stages of Small Business Growth, Neil C. Churchill and Virginia L. Lewis, May 1983 Issue.

https://hbr.org/1983/05/the-five-stages-of-small-business-growth

5 Stages of Business –
Adapted from the Harvard Business Review

Stage 3. Success Story (“Stay or Grow”)

- The decision facing owners at this stage is whether to exploit the company’s accomplishments, **expand or keep the company stable and profitable** providing a base for alternative owner activities.
- What are the business’ **sales projections**? How long will it take for your sales to meet your costs?

Stage 4. Take Off (“How Quickly Can and Should We Grow?”)

- In this stage, the main concerns are **how to grow rapidly and how to finance that growth**. Among the key questions are:
- Will there be **enough to satisfy the great demands growth brings** […] **and a cash flow that is not eroded by inadequate expense controls or ill-advised investments** brought about by owner impatience?

Courtesy: Harvard Business Review: The Five Stages of Small Business Growth, Neil C. Churchill and Virginia L. Lewis, May 1983 Issue.
https://hbr.org/1983/05/the-five-stages-of-small-business-growth

Wacif

5 Stages of Business –
Adapted from the Harvard Business Review

Stage 5. Maturity ("We Have Arrived.")

- In this stage, the main concerns are: (1) to consolidate and control the financial gains brought on by rapid growth and (2) to retain the advantages of small size, including flexibility of response and the entrepreneurial spirit.
  - Is management is **decentralized, adequately staffed**, and **experienced**?
  - Are the owner(s) and the business **clearly separate, both financially and operationally**?

Courtesy: Harvard Business Review: The Five Stages of Small Business Growth, Neil C. Churchill and Virginia L. Lewis, May 1983 Issue.
https://hbr.org/1983/05/the-five-stages-of-small-business-growth

Wacif

Understanding financial needs and use of funds

Use of Funds

- ❑ Pay Bills
- ❑ Meet Obligations
- ❑ Debt Service

Ensure Survival

- ❑ Purchase Inventory, Equipment
- ❑ Account Receivable Support
- ❑ Working capital

Make a Profit

- ❑ Purchase Building, Land, Machinery

Long Term Growth

Debt Financing - Forms

- Traditional
  - Self-Financing (aka “bootstrapping”) (401k, Home Equity Loans, etc.)
  - Banks & Other Conventional Lenders:
    - Term Loans (with or without SBA 7a or SBA 504 program) guaranty)
    - Line of Credit
- Alternative
  - Asset Based Loans
  - Purchase order financing
  - Accounts Receivable financing
    - Factoring*- The practice involves a financing company, or "factor," advancing you money based on its buying your receivables at a discount; your customers pay the factor the full value later, when the bill is due. Factoring gets you cash in hand immediately--but at a steep price.

Wacif

Debt Financing -Types

Term Loan

Fixed monthly payment for a set term/period. (Principal and interest)

Usually for real estate acquisitions, leasehold improvements, furniture, fixtures & equipment purchases, or acquisition of a business.

Line of Credit

Monthly interest payment due on outstanding principal balance. Generally 6-12 month tenor. Principal due in full at maturity or at Lender's demand.

Use for working capital needs such as accounts receivable, payroll and inventory.

May include a mandatory with cleanup provision.

Bridge Loan

A type of short-term loan, typically taken out for a period of 2 weeks to 3 years, pending the arrangement of larger or longer-term financing.

Equipment /Inventory Loans

Shareholder Loans

Business Credit Cards

Home Equity Loan, 401K, Cash Surrender Value of Life Insurance

Wacif

Why Use Debt?

Best for: Companies with defined cash flow cycle, but can be attained in start-up phase

Upside

- A variety of debt instruments exist to meet specific financing needs
- Assists businesses to maintain control
- Unlike investors, lenders cannot direct how you run your business.
- Accessibility and flexibility to negotiate term and payment structure

Downside

- Requires sound management of cash flow across seasons and cycles
- Challenging for startups, seasonal businesses, and high risk industries
- Repayment terms are not flexible.
- *Debt has to be repaid every month, regardless of how well your business is operating*

Wacif

The 5 C's of Credit – Lending & Credit

Whether you are seeking financing from a bank, nonprofit loan fund, a local community development corporation or a family member, all lenders will analyze your creditworthiness. **The "5 C's" are the basic elements of credit analysis**.

1. **Character – "Are you trustworthy to repay the loan?"**

   Considers: Credit reports (personal and business), References, Work/Industry experience, Public records, Digital footprint

2. **Capital – "Personal investment into the business"**

   Considers: Have you contributed from your own assets and assumed personal financial risk to establish the business? (Before you seek any financing)

The 5 C's of Credit

3. **Capacity – "Ability to repay"**

   Considers: the cash flow from the business, the timing of the repayment, other possible sources of repayment, and the probability of successful repayment. Payment history on existing personal and business credit relationships

4. **Collateral – "Home, Investment Property, Contracts, Inventory, Equipment"**

   Considers: Pledge of personal and/or business property or assets to Lender in the event of a default

5. **Conditions – "Loan Purpose and Economic Landscape"**

   Considers: Sector of business, Competitive landscape, Growth and attractiveness of industry, Economic conditions of the market

Wacif

Financial Statements

There are three main financial statements used to understand your business:

1. **Balance Sheet**

2. **Profit and Loss Statement (Income Statement)**

3. **Cash Flow Statement**

Balance Sheet tells about your business

It is a snapshot at one point in time and tells:

What your business owns (Assets)?

What you owe to others (Liabilities)?

What your business is worth (Equity)?

How assets are used to operate the business?

How liabilities are used to finance the assets?

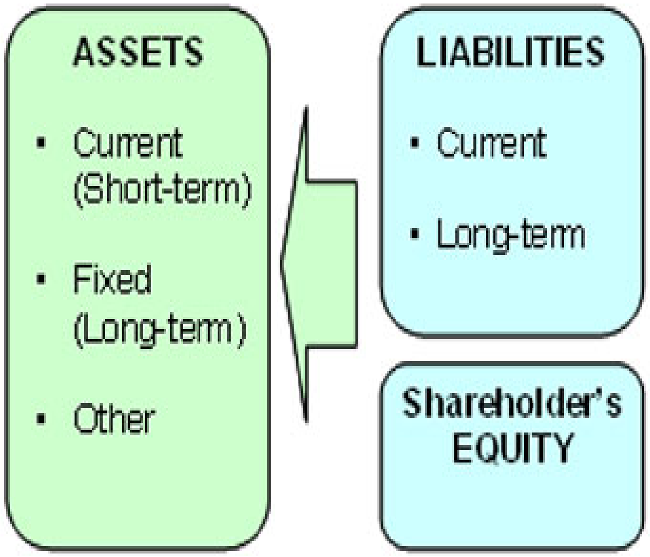
Wacif

How the Balance Sheet Works

The balance sheet is divided into two parts that, based on the following equation, must equal each other or balance each other out.

Assets = Liabilities + Shareholders' Equity

This means that assets, or the means used to operate the company, are balanced by a company's financial obligations, along with the equity investment brought into the company and its retained earnings.



Wacif

Balance Sheet Analysis – Lender wants to know:

1. What **type of assets** does the company have? What is its **value**?
2. Looking at its **accounts receivables** reported, does the business **collect/get paid** for its services?
3. How does the company control **inventory**?
4. Does the company **pay its bills**?
5. **How much of your loan debt is current (due in 12 months or less), and how much is long-term (greater than 1 year maturity)?**
6. What is **net value** of the business?
7. Looking year-by-year, how has the business performed? Has its value increased/decreased? Did it experiences losses that affected its retained earnings?
8. **Has the owner taken money out of the business?**

Wacif

Income Statement or Profit and Loss (P&L) Statement

- It is a **record of a company's operations** (Revenues and Expenses).
- Will tell how the business performed during a **certain period**.
- It is an **indicator of a company's ability** to buy and sell inventory/services **to make a profit**.
- Will tell if the business is **earning a sufficient margin**?

Wacif

P&L Analysis: The Lender Wants To Know

1. Are sales are going up or down?
2. What it costs to produce or purchase the product?
3. What are the business' expenses?
4. Net profit — How much money is left after all expenses are paid?
5. Is there any money left to grow/invest the business?
6. How much money is available to pay debt (existing and requested)?
7. How much money does the owner receive from the business?

Wacif

Cash Flow Statement

Demonstrates how much cash flows in or out of the business over a period of time.

- Does the business have enough cash to pay day-to-day expenses?
- Pay bills on time?
- Shows seasonality or temporary short falls and/or surpluses.
- Reconciles the P&L and balance sheet.

Wacif

Cash Flow Analysis – The Lender Wants to Know

1. Does the business has **enough money** to cover day-to-day activities? pay debts on time? maintain and grow the business without a negative cash flow?

2. **The breakdown of principal and interest on your loan payments.** (Note: the Income Statement only shows interest - not principal.)

3. Business and/or owner weaknesses (an inability to keep and generate cash).

Wacif

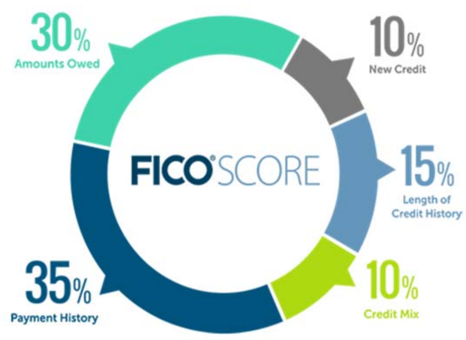
What is the Purpose of Financial Projections?

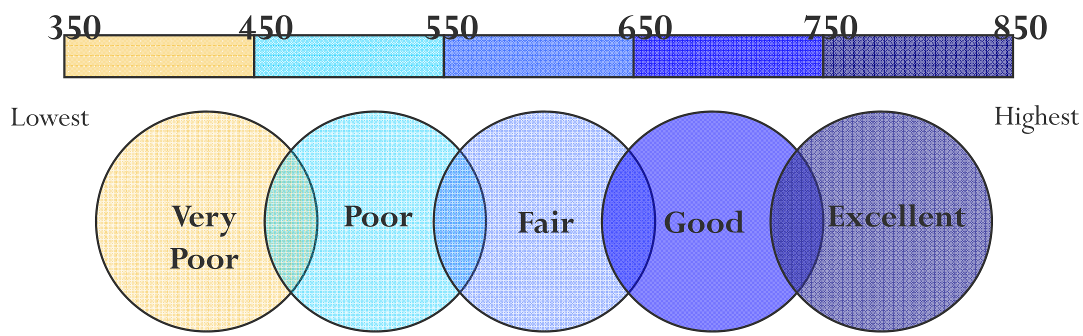
- Financial Statements deal with present and past financial information. Projections help you set sales targets, pricing and appropriately plan for the future.
- Through forecasts or projections, you can examine various “what- if” scenarios to ensure that your company will have the required cash flow to achieve your business goals.
- To prove to investors, potential lenders (and yourself), that the business makes sense from a financial standpoint and that you understand your financial need.
- Projections provide a method of translating your market opportunity and operations into cash flows, income and expenses.
- To determine the financial resources need to grow your business.

Projections: Lender Wants To Know

1. At what point, **will the business start operating in the black** (positive net income)?
2. According to the projected income statement, **when will it be profitable** during Year1, Year 2, etc.?
3. What will be the **growth rate of sales** for Years 1, 2, 3, and beyond? On what is this based?
4. What will be the **growth in net income** (profit)?
5. How will **loan funds be allocated** ?
6. **How will these funds be repaid?**
7. **How long will it take pay back the loan in full?**

Your Credit: Credit Score





Source: www.truecredit.com

- Credit scores range from 350-850, generally
- Banks seek 700+, generally
- Non-traditional lenders seek 600+, generally

Your Credit Report: What Lenders Want To Know

Types of negative information	Maximum time on credit report
General civil judgments	7 years from the date filed
Tax liens	7 years from the date paid (If tax lien is not paid, it will remain on file indefinitely.)
Chapter 13 bankruptcies that have been dismissed or discharged	7 years
All other bankruptcies (such as Chapter 7)	10 years

Wacif

Summary & Takeaways – What the Lender Wants to Know

- ✓ Cash flow for debt service
- ✓ Strong financial management
- ✓ Documented financial controls
- ✓ Process for budgeting and projections
- ✓ Financially sustainable business lines
- ✓ Diversified revenue
- ✓ Staff resources
- ✓ Business risk

Wacif

Loan Application Process
Generally Required Documents Checklist

- Completed Loan Application (with application fee)
- Business plan (or Executive Summary)
- Business Tax Returns (at least 3 years)
- Personal Tax Returns (at least 3 years)
- Financial Statements (P&L and Balance sheet, at minimum)
- Copy of current lease
- Project/Contract management Report
- Credit Report (Personal and/or Business)
- Corporate Documents
- Evidence of Insurance, Business License

Government Financing

Mobilization

Working Capital

- Notification to Proceed
- Generally up to 30% Mobilization or $350,000
- Term of Project
- Ability to Perform
- Interest Only & Principal Repayment Structure

Wacif

Concluding Tips

1. Know your revenue stream(s) and cost drivers.
2. Be prepared to answer the following questions:

How much money will you need?

How will the money be used?

What is the length of time that you need the money?

What type of repayment structure are your requesting?

Do you have other resources or assets you can use to reduce the loan amount?

Do you have collateral?

Questions & Answers