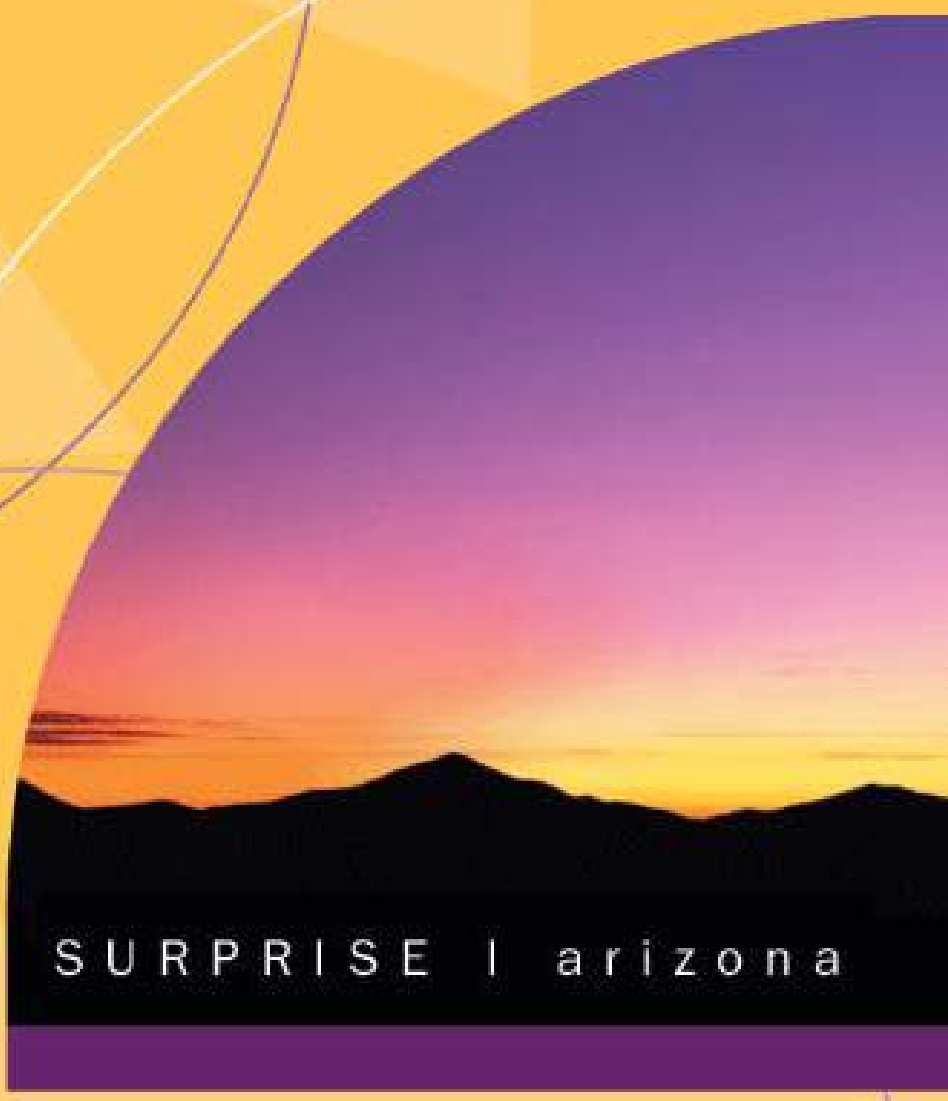

Doing Business In Surprise

Chapter 7

November 2005

Chapter 7: Securing Financing

Within this chapter:

- ***Finding the Money You Need***
- ***How Small Business Loans Are Reviewed***
- ***How to Write a Loan Proposal***

Finding the Money You Need

One key to a successful business start-up and expansion is your ability to obtain appropriate financing. Raising capital is the most basic of all business activities. Many new entrepreneurs quickly discover that raising capital may not be easy; in fact, it can be a complex and frustrating process.

However, if you are informed and have planned effectively, raising money for your business will not be a painful experience. This information summary focuses on ways a small business can raise money and explains how to prepare a loan proposal.

There are several sources to consider when looking for financing. It is important to explore all of your options before making a decision.

Personal savings: The primary source of capital for most new businesses comes from savings and other forms of personal resources. While credit cards are often used to finance business needs, there may be better options available, even for very small loans.

Friends and relatives: Many entrepreneurs look to private sources such as friends and family when starting out in a business venture. Often, money is loaned interest free or at a low interest rate, which can be beneficial when getting started.

Banks and credit unions: The most common source of funding, banks and credit unions, will provide a loan if you can show that your business proposal is sound

Venture capital firms: These firms help expanding companies grow in exchange for equity or partial ownership.

Your Financing Options

The owner of a new business must plan carefully to capitalize his or her business according to its needs. One of the major causes of small business failure is inadequate start-up capital. An entrepreneur needs to identify the actual start-up capital needed to launch the business and the ongoing cash flow needed through the break-even point. The sum of these two plus a reserve add to the total capital needed to open the doors of a new firm.

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You should ask yourself exactly why you need the money. Know exactly how you plan to spend the money and what you plan to buy to start your business. Keep this fact in mind while you are making your plans: most businesses do not generate profit for several months or years. You need to have enough in reserve to pay all the business expenses plus your personal living expenses while raising your business to a profitable level. This should be planned in advance so short-run cash shortages do not pull you under. Never underestimate the importance of starting with enough money. It is certain to take more than you expect, and yes, it is much more difficult for the small business owner to raise financing for his or her new ventures.

The owner who borrows too little up-front money may quickly see the business close because of lack of capital to keep the operation running. According to SCORE (*Service Corps of Retired Executives*), the most hazardous period for a new business is the first two years. Early failure is often due to insufficient working capital.

SOURCES OF CAPITAL

When you plan the capital requirements of your new firm, you can consider two different forms of money: equity and debt.

Equity:

Equity is ownership in the business. Equity can come from you or from someone else. Since it is ownership, it implies a degree of risk and a degree of control over the conduct of the business. If you sell an equity share to someone else, the buyer could lose his or her money if the business does not work out. On the other hand, if the business is successful, all owners will share the profits. And it is likely that an investor will want to have some say in the way the business is run. If you are not willing to give up some control, then a silent partner may be right for you. If you do this, however, be sure to get your agreement in writing.

Sources of Equity Capital:

Yourself: You are the most likely source of start-up capital for your business. Use your savings, cash value of life insurance, or the proceeds from selling other personal assets to open your business. Perhaps a mortgage on the equity in your home may be an option.

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Other individuals: Once you have exhausted your own resources, consider relatives, friends, or other local investors. The investor wants a high return for low risk. If your risk is high, you will likely have to show a very high return to attract an investor.

Be sure about what you are getting. Is it a loan, which must be repaid, or an equity share, which gives the investor an ownership stake in the company? If you form a corporation, you can sell stock. A stock offering is an area you should discuss with a competent attorney since it involves federal and state securities laws that can include criminal penalties. Stock is not the only product considered to be a security. Any time you accept money in return for an equity or debt interest in an enterprise, you may be selling a security subject to federal and state securities laws. A security can include a limited partnership interest and even a promissory note.

As a prospective new business owner, you will find that banks generally will not lend the full amount needed to start a business. They want the owner to have a serious financial stake in the outcome. Most banks today want you to come up with a third to one half of the start-up funds. This will mean that you have a strong commitment to making the business work. Banks and other lenders are not usually risk takers; they like security and certainty. Realize this fact and present your loan request professionally. Be businesslike in your dealings with potential lenders.

Debt:

Debt is a loan that you obtain, usually in the business name. As such, it must be repaid. While there can be many sources of debt capital, remember that in every case you must pay the loan back according to the terms you agreed on before you took out the loan. Remember that loans usually involve an extra charge or cost known as interest, that is, the price you pay for the use of someone else's money.

More information from the ASU Center for Nonprofit Leadership and Management:

http://www.asu.edu/copp/nonprofit/asst/asst_ask_faq_how.htm

Sources of Debt Capital:

Trade Credit: Some suppliers will put inventory into your business and bill you 30 days later. Suppliers can be a real help in starting your business, but be certain to pay on time or you may lose the credit privilege.

Leasing*:* Leasing can offer advantages to the new business. Low down payments and fixed monthly costs can add to predictability and help the

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businessperson converse cash in the beginning. Check with your tax advisor about possible tax consequences.

Bank Loans: Banks lend for either short or long term. Be sure you know what you want. Normally, banks tie the terms of a loan to the assets bought by the funds; short-term needs receive short-term funding.

Term Loan: A conventional bank loan with a lump sum paid to the borrower and the monthly payments, plus interest, repaid until the loan is paid off.

Revolving Line of Credit: A fund which can be borrowed against and paid again and again; the debt goes up and down periodically. A line of credit is useful if your business is seasonal or if you have long lags between making a sale and collecting the payment.

Short-Term Financing: Usually through notes and paid on a revolving or non-revolving basis within one year. These notes are repaid through inventory turnover or by converting receivables to cash within the time frame of the note provided

Intermediate-Term Financing: Ranges from one to ten years, and is usually repaid in fixed monthly payments or fixed principal payments plus interest. These loans are repaid from operating cash flow. This type of financing is generally used to purchase capital assets such as equipment.

Long-Term Financing: Provided for periods of longer than ten years. The most common example is real estate financing, where repayment is made on a prearranged schedule over a long period of years.

SBA Guarantee Program: The U.S. Small Business Administration, established in 1953, provides financial, technical and management assistance to help Americans start, run, and grow their businesses. SBA is the nation's largest single financial backer of small businesses. Last year, the SBA offered management and technical assistance to more than one million small business owners. It provides short and long-term loans to eligible, creditworthy, start-up and existing small businesses than cannot obtain financing on reasonable terms through normal lending channels. The SBA provides financial assistance through its participating lenders in the form of loan guaranties, not direct loans. Loans are available for most business purposes, including the purchase of real estate, machinery, equip-

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ment, and inventory, or for working capital. The SBA generally can guarantee a maximum of $1,000,000 under this loan program. See http://www.sba.gov/financing/.

Franchising: If you are buying a franchise, the business can sometimes be a source of funds if the franchiser has a working relationship with a lender. If the lender has confidence in the franchiser and the system, it may be willing to fund a new franchise operation.

Government Sources: These sources are sometimes available. Contact the Arizona Department of Commerce to see if your idea qualifies for Industrial Revenue Bonds, Urban Development Action Grants, Arizona Enterprise Development Corporation programs, or other Revolving Loan Programs.

Commercial Finance Companies: These companies can make short or long-term loans to buy inventory and provide funds for accounts receivable or purchase equipment.

Loan Proposals

How Small Business Loans Are Reviewed

When reviewing a loan request, the lender is primarily concerned with repayment. Loan officers judge loan applications based on what is commonly referred to as the five C's of Credit:

CHARACTER

Lenders will order a copy of your credit report and look at debt repayment trends. They want to know simply if you pay your bills and if you pay them on time. If there are blemishes on your report, explain them. (See the end of this chapter for more information on credit reporting.)

CASH FLOW

Lenders will look at historical and projected cash flow statements to determine whether you will be able to repay the loan and still have money to adequately run the business. Include written justification for your projections in your loan proposal.

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TOP TEN REASONS FOR DECLINE

- *Borrowers that have no formal business plan*
- *Borrowers that are not prepared*
- *Borrowers with inadequate financial data*
- *Borrowers that are too optimistic*
- *Borrowers that wait for a crisis to react*
- *Borrowers that demand an answer immediately*
- *Borrowers that frequently overdraw their checking account*
- *Borrowers that are not sensitive to economic conditions*
- *Borrowers that want to grow too quickly*
- *Borrowers that surprise their banker*

COLLATERAL

Collateral is an asset (something you own) which a lender may claim to satisfy a loan in the event the loan is not repaid according to the required terms. Often the assets purchased with the loan may serve as collateral. If the business does not have enough collateral, the bank will look to personal assets.

CAPITALIZATION

Capitalization refers to the basic resources of the company including owner.

CONDITIONS

Factors that affect the success of the company yet are external to the business will also be considered by the lender. Examples include government regulation, competition, and industry trends.

What to Take to the Lender

Business financial statements, or tax returns and personal financial statements are required from all owners and guarantors.

Applications from start-up businesses must include a business plan. Loan requests to purchase an existing business must include a copy of the sales agreement and a financial statement on the existing business, as well as a statement of benefit to the business as a result of the purchase. Sale of a business among family members may be eligible; the relationship of a buyer and seller must be disclosed on the application.

APPENDIX A: Useful Contacts and Websites

Office of Economic Development—City of Surprise

12425 W. Bell Rd., Bldg. D-100
Surprise, AZ 85374
Phone: (623) 875-4273
Fax: (623)875-5049
Web site: www.surpriseaz.com
E-mail: econdev@surpriseaz.com

Determining where to start is not always easy. If you aren't sure who to contact or what steps to take, Surprise's Economic Development Department is a great place to begin.

The Economic Development staff will be happy to assist you in determining a path to start your business, expand an existing business, or find a new location. The Economic Development Department offers business firms an ombudsmen service to assist with the City's development process, increase understanding of regulations and assess project needs. Staff can also provide introductions to other departments or additional resources.

The Economic Development Department has services designed for both new and existing businesses—from small entrepreneurial operations to Fortune 500 firms. Services include confidential consultations, assistance with site selection, introduction to private and public sector development and real estate representatives and providing demographic information to assist potential new business owners.

Surprise's Office of Economic Development actively promotes and preserves the economic strength of the city to ensure that Surprise is the preferred location for new, existing and expanding organizations.

Northwest Valley Chamber of Commerce

12801 W. Bell Rd., Suite 14
Surprise, AZ 85374
Phone: (623) 583-0692
Fax: (623) 583-0694
Web Site: www.northwestvalley.com
E-mail: chamber@northwestvalley.com

The Northwest Valley Chamber of Commerce is a private, not-for-profit business organization providing a wealth of information for any size business. For more than 42 years, the Northwest Valley Chamber of Commerce has been a leading advocate for businesses. The Chamber also acts as an ombudsman for resolution of public policy issues that affect the business community at a local, county or state level.

As one of the largest Chambers in metropolitan Phoenix, members are given many opportunities to market their businesses and to enhance their business skills through individual counseling, group workshops and networking activities. The chamber also hosts monthly seminars and events to assist our members.

APPENDIX A: Useful Contacts and Websites

Maricopa County Regional Library - Surprise

16089 N. Bullard Ave.
Surprise, AZ 85374
Phone: 623-544-6371
Web Site: maricopa.gov/library

The Surprise Library is a great business resource and contains various business materials, government and legal documents and "how to" publications on such topics as how to start a business, how to get a loan and how to write a business plan. The Northwest Regional Library is located in the Surprise Recreation Complex in the City of Surprise. This 23,000 sq. ft. facility is the District's newest "state of the art" Regional Library with a collection of over 40,000 items in all formats and offers over 60 Internet-accessible computers throughout the building. It is a model of the latest technology in the library and information field in terms of customer service with self-checkout, self-check in and Smart Library Cards.

Arizona Department of Commerce

1700 W. Washington St., Suite 600 Phoenix, AZ 85007
Phone: (602) 771-1100 Toll free: (800) 528-8421 Fax: (602) 771-1209
Web site: www.azcommerce.com E-mail: webmaster@azcommerce.com

The Arizona Business Assistance Center, a division of the Arizona Department of Commerce, provides a variety of resources to assist anyone interested in starting, expanding or relocating a business in the state. The Arizona Business Assistance Center has three components and are located at the Arizona Department of Commerce.

Arizona Business Connection

Web site: http://www.commerce.state.az.us "Small Business Services" page; then go to "Arizona Business Connection - Walks you through what you need to know to start or expand your business"
Phone: (602) 771-1196 Toll free: (800) 542-5684

The Arizona Business Connection's Web site provides regulation and licensing information for starting a business. At this Web site, you may also create a customized information package to print at your convenience. This office also produces the free publications, Guide to Establishing and Operating a Business, Small Business Book and Entrepreneur's Encyclopedia, available at the Chamber of Commerce and Regional Library. To obtain copies of these publications, visit the Library or call (623) 544-6371 or drop by the Northwest Valley Chamber of Commerce at 12801 West Bell Rd., Ste. 14, Surprise, AZ 85374. Phone (623) 583-0692
Fax (623) 583-0694. Web page chamber@northwestvalley.com

APPENDIX A: Useful Contacts and Websites

Office of Minority/Women-Owned Business Enterprise Services

Phone: 602-262-6790 http://www.azcommerce.com/mwbedir/

The Office of Minority/Women-Owned Business Enterprise Services acts as a resource and advocate for women and minorities who own businesses by helping them market their products and services to state agencies and other companies. The office publishes a directory of women and minority-owned businesses that is distributed to state agencies, local corporations and financial institutions.

Small Business Advocate—Governor's Council on Small Business

1700 West Washington, Suite 220 Phoenix, AZ 85007

Email: gcsb@azcommerce.com **Telephone:** 602-771-1173 **Fax:** 602-771-1209

The Small Business Advocate maintains ongoing communication between the Governor's Office and small business. The advocacy office works with chambers of commerce and other groups to develop policies and programs relevant to small business, supports state legislation that benefits the business community, and interacts with state agencies to improve relationships between state departments and the small business community.

Arizona Secretary of State's Trademark and Trade Name Office

Phoenix Customer Service Center
14 N. 18th Ave just across street from the Capitol Executive Tower
Mailing Address 1700 West Washington, 7th Floor Phoenix, Az 85007-2888
Phone (602) 542-6187 or 800.458.5842
Web site www.azsos.gov/business_services/trademarksandtradenames.htm
Email trades@azsos.gov

Arizona Corporation Commission

1300 W. Washington Street Phoenix, AZ 85007 (602) 542-3230
www.cc.state.az.us http://www.cc.state.az.us/corp/filings/forms/packets.htm

Maricopa County Recorder

Main Office (Downtown) 111 S. Third Ave., Phoenix AZ 85003 Phone: 602-506-3535
Southeast Office (Mesa) 222 E. Javelina, Mesa AZ 85210 Phone: 602-506-3535
http://recorder.maricopa.gov

Arizona Department of Revenue (ADOR)

2902 W. Agua Fria Freeway Phoenix, AZ 85027
Phone: (602) 255-2060 Forms by Phone: (602) 542-4260
Web site: www.revenue.state.az.us Forms by Fax: (602) 542-3756

"Business Basics: A Guide to Taxes for Arizona Businesses," is found online at http://www.revenue.state.az.us/brochure/622.pdf

SURPRISE
ARIZONA
Beyond Expectations

City of Surprise
Economic Development
Department

12425 West Bell Road
Building B

Phone: 623.875.4273
Fax: 623.875.5049
E-mail: econdev@surpriseaz.com

City of Surprise
Small Business Assistance Program (SBAP)

Interested in starting your own business? We'll help you get your business started and serve as an on-going resource. We'll work with you as long as you need help.

Through the SBAP, Surprise offers one-on-one coaching and counseling to existing and would-be entrepreneurs, helping them establish business plans and access private and public resources. Our Economic Development staff is complemented by a network of volunteers with business expertise. Go to www.surpriseaz.com—Economic Development Department—or call 623.875.4273 for more information.

12801 West Bell Rd., Ste. 14,
Surprise, AZ 85374
Phone: 623.583-0692
Fax: 623.583-0694
Email: chamber@northwestvalley.com

Welcome Business Partners!

The Northwest Valley Chamber of Commerce encourages you to become a business partner with the Chamber and become active in one of the most vibrant business organizations in metropolitan Phoenix.

The Chamber is adept at providing assistance with marketing your product or service, finance options for your business, leads, seminars and workshops, several networking options as well as events to showcase your products.

Chamber members are at the very heart of the region's success. Through their commitment to the community, they create a partnership between local businesses and residents. Chamber members provide more than membership dues. They are volunteers, leaders and advocates for optimum quality of life in the Northwest Valley.

Long before there were thousands of rooftops in the area, there was the Chamber of Commerce. Early business owners recognized the potential of the Northwest Valley and banded together to create a thriving economy and a great place to live. We thank the early pioneers in the region. They created the strong base for the growth and accomplishment that was to follow years later.

Join us; won't you? We're always looking for people who share our values and goals: pursuing all of the good things in life, right here in the Northwest Valley. Stop by the Chamber office any weekday and learn a lot about local life.