

## Entrepreneur Resource Guide

# Chapter 2

## FINANCING YOUR BUSINESS



THE WOMEN'S BUSINESS CENTER AT  
**Community First Fund™**

Offices in Lancaster, Harrisburg, York, Reading and Exton  
See website for more contact information.

[www.commfund.org](http://www.commfund.org)

### Chapter 2:

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### Sources and Types of Funding

#### WHERE TO BORROW:

Getting credit for a business can be a dilemma because until you've developed a good track record with business credit, commercial banks and other lenders may be reluctant to extend credit to you. To identify the type of financial institution most likely to lend to your business, it's helpful to pinpoint which of the four early stages of development your business is in.

- **Stage One** businesses are concepts
- **Stage Two** businesses have business plans and product samples but no revenues
- **Stage Three** businesses have full business plans and pilot programs in place
- **Stage Four** businesses have been in operation for some time and have documented revenues and expenses

#### **Stage One and Two**

Stage one and two businesses with little or no personal capital should first seek financing from informal investors. Informal sources of funding may include, but are not limited to:

Friends and Relatives; Business Partners; Small Business Administration loan guarantee programs; Local Economic Development Organizations; State and Local Governments offering low-interest loans; Private Foundations offering investments in your business area; Credit Unions featuring small business lending; Colleges and Universities with public research and development funds

#### **Stage Three and Four**

Some qualified Stage Three businesses and Stage Four businesses are sufficiently developed to approach a more traditional source of financing, such as a bank or commercial lending institution. Businesses in these stages should first discuss and apply for financing at a bank with which they have an established relationship.

#### **NOTE:**

Keep in mind that you must choose a legal designation (sole proprietorship, partnership or corporation, etc) and file all necessary documentation prior to seeking financing for your small business. For more information on legal designation, please see Chapter 1.

## ITEMS THAT LENDERS REVIEW

Regardless of your funding source, a prospective lender will review your creditworthiness. To assist the lender in this process, you should submit a complete and detailed loan application. This documented request, which should include a business plan, will allow the lender to understand your personal finances and your business.

### Loan Types

The purpose of the loan is critical in determining the type of loan to request. You also should make sure that the timing of the repayment schedule on your loan matches the incoming cash flow you will use to make the payments. The primary types of loans are:

- **Term Loan** - A term loan is typically requested to purchase fixed assets or provide working capital. Term loans are repaid over a period greater than one year with payment terms set according to the borrower's cash flow and the life of the asset being financed, if applicable.
- **Line of Credit** - This type of credit allows you to borrow repeatedly up to a predetermined credit limit. You may continue to borrow and repay subject to the terms and conditions of the line of credit. Interest is usually payable monthly.
- **Time Notes** - Can be used to tide a person over a number of months or until a specified date when expected funds will have come in and the loan can be paid in full.
- **Mortgages** - A loan to finance the purchase of real estate, usually with specified payment periods and interest rates.

Community First Fund offers a variety of loan products to fit individual needs, such as:

#### • **SMALL BUSINESS LOANS:**

Up to \$35,000 for the starting of new businesses or expansion of existing businesses. Uses may include machinery and equipment purchases, site improvements, working capital, inventory, materials and supplies, and expansion.

#### • **MID-SIZED BUSINESS LOANS:**

From \$35,000 for businesses that have typically been in business for two years or more. Loans are used to support the increased capital needs of maturing businesses and may be used for such things as expanding or improving the business site and services provided, increasing supplies, materials and/or staff.

#### • **COMMUNITY DEVELOPMENT LOANS:**

For non-profit and community organizations to maintain, expand, or develop community-based programs.

#### • **AFFORDABLE HOUSING LOANS:**

For-profit and non-profit developers to rehabilitate or create affordable housing for rental or resale.

Community First also provides a variety of business counseling services and training. For a better understanding of which loan service fits your business, contact of Community First loan officer in your region. For a listing of offices, see our website.

Loans are provided in a variety of forms. A loans features will be tailored to your business based on the needs of your business and your ability to repay. Below are a listing of a variety of features of loans.

### FEATURES OF LOANS:

- **Term:** loans are long, medium and short term
- **Interest rate:** vary depending on the term, type, size, collateral and risk of the loan
- **Payment:** may be a lump sum; on a monthly, seasonal or interest only schedule; or may be delayed until the funds help your business generate cash flow
- **Collateral:** assets pledged by a borrower to secure a loan or other credit, and subject to seizure in the event of default

## Loan Agreements

You should be aware that your lender would expect you to agree to certain performance standards and restrictions to ensure that your business can repay the loan. These restrictions, known as covenants, representations, and warranties, commonly include the following:

- Maintenance of accurate records and financial statements
- Limits on total debt
- Restrictions on dividends or other payments to owners and/or investors
- Restrictions on sale of fixed assets
- Performance standards on financial ratios
- Current tax and insurance payments.

## Questions your lender may ask to evaluate your loan:

- Do you have a clear idea of how much you need to borrow along with a detailed list of uses of funds?
- Do you have a plan for repaying the loan?
- How long do you want to borrow the money?
- How do you plan to secure the loan (what collateral can you offer)?

## Credit Analysis

The basic components of credit analysis, the “Five C’s,” are described below to help you understand what the lender will take into consideration.

### Capital

The portion of business equity that has been invested by owners, in contrast with the part that has been borrowed. Lenders believe the greater your stake in your business, the more you will want to make it succeed.

*Example:*  
*10% to 20% of cash invested for the project*

### Capacity

Your ability to repay the loan. Lenders consider your recent cash flow and your expected cash flow to predict whether you will have sufficient profit to make all payments by the due dates.

*Example:*  
*Positive net worth: assets > liabilities (debt)*

### Collateral

A secondary or “backup” source of repayment. Collateral is any asset, business or personal, that you can offer as security for your loan. In the event that you are unable to pay the debt with cash flow, your collateral can be used to pay off your debt as agreed.

*Example:*  
*Real estate, machinery & equipment and furniture & fixtures*

### Conditions

Factors in the economy, your industry and your geographic area that could favorably or unfavorably affect your business. Lenders look at the present conditions which may predict future events.

*Example:*  
*Zoning restrictions or an over abundance of similar businesses*

### Character

Your commitment to repay the loan. Lenders consider your financial status, your previous credit history and your previous loan payment record. A strong repayment history demonstrates that you are financially responsible.

*Example:*  
*Your personal repayment history on other debt*

## The Loan Application Process: What We Need and Why We Need It

### What:

**Annual Financial Statements/ Business Tax Returns** – Last Three Years

**Current Interim Financial Statements** (if available)

**Personal Financial Statement and Individual Tax Returns**

**Financial Statements for all Related Businesses** – Last Three Years

**Collateral** – A backup or secondary source of repayment if a loan cannot be paid from the cash generated by the business

### Why:

To verify business performance, income, cash flow, and payment history

To see income and expenses between tax periods

The ability to produce cash at any time shows personal stability

To see patterns, trends and relationships

To verify what security may be made available if your business is not profitable enough to make required payments

## Tips for Receiving a Loan

The best start to financing is preparation and openness. Be prepared to give information about the business, business plan, financials and projections. Be open to questions about your credit history, job history and any previous financial difficulties - this is most important as a sole proprietor. Remember, a loan officer's number one priority is the repayment of the loan, so they are interested in your ability to repay. This is good, because repayment is a great indication of the success of the business!

### THREE THINGS TO DO BEFORE APPLYING FOR A LOAN:

- 1. Have a sound business plan.** Writing down your business idea is a great first step, but helping another person understand the ins-and-outs of your business can only happen through a business plan. A business plan will solidify your idea and will provide guidance for future steps as the business grows.
- 2. Invest your own money.** Show that you think the business will succeed by investing up to 25% of the cost with your own money. Lenders see your money as

insurance that you will work hard in your business.  
**3. Check your credit report.** Lenders use the report to know about your personal financial responsibility. Review the report to see what they see and to correct any errors that affect your score.

### Other Sources: For Technical Assistance

#### U.S. SMALL BUSINESS ADMINISTRATION (SBA)

The U.S. Small Business Administration is an independent federal agency created to assist and counsel small businesses. The SBA acts as an advocate for small business and also provides prospective, new and established businesses with financial assistance, management counseling, and training. Community First is a qualified SBA lender and is able to access federal guarantees and services for small businesses.

Contact one of the SBA offices nearest you or access SBAs web page at [www.sba.gov](http://www.sba.gov).

#### SMALL BUSINESS DEVELOPMENT CENTERS (SBDCs)

Assistance from an SBDC is available to anyone interested in going into business or improving and expanding an existing small business. Although most of these services are free, there are minimal fees for some courses, workshops or other services.

Contact the SBDC at Kutztown University: <http://www.kutztownsbdc.org/> or the SBDC at Lehigh University: <http://www.lehigh.edu/~insbdc/index2.htm>

#### SCORE

SCORE's offers free advice from both working and retired executives and business owners who donate time and expertise as business counselors.

Visit SCORE's website to find the location nearest to you: <http://www.score.org/>

#### PA SMALL BUSINESS RESOURCE DIVISION

The Resource Division has select state forms and applications, plus information on government funding sources, permits and licensing, and sources of technical assistance.

PA Department of Community and Economic Development  
Center for Entrepreneurial Assistance  
400 North Street, 4th Floor  
Commonwealth Keystone Building  
Harrisburg, PA 17120-0225  
1-800-280-3801 or 717-783-5700  
[www.inventpa.com](http://www.inventpa.com)

## The Women's Business Center at Community First Fund

The Women's Business Center at Community First Fund provides training, customized business counseling, loan capital, and advocacy support to small business enterprises. The goal of the Center is to develop more knowledgeable, better prepared business owners through these services and outside resources.

The Women's Business Center also offers special topics seminars, covering a variety of business issues such as gaining access to capital, marketing, networking, and certification as a Women's Business Enterprise (WBE). Additional training topics include financial literacy, computer literacy, and e-commerce. By counseling and training entrepreneurs in the proper use of computer technology and small business software, you will have a level of knowledge that enables you to access information that can impact sales, marketing, and operations.

Find out more about training classes available through the Women's Business Center by contacting Jamie Frey at [jfrey@commfirstfund.org](mailto:jfrey@commfirstfund.org) at 717-393-2351 or visiting the website: [www.commfirstfund.org/womens-business-center](http://www.commfirstfund.org/womens-business-center).

### ENTREPRENEUR RESOURCE GUIDE

- Chapter 1: Starting Your Business
- Chapter 2: Financing Your Business
- Chapter 3: Marketing Your Business

This is a publication of Community First Fund. For more information on starting a business see our website or talk to one of our lenders.



Community First Fund™  
capital powering prosperity

[www.commfirstfund.org](http://www.commfirstfund.org)  
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