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Starting Your Own Business

Obtaining Capital

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developed by
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Obtaining Capital For Your Business

Capital is defined as money or assets which can be turned into cash that a person or company uses in carrying on a business. It comes in many forms such as:

1) Money
2) Stocks and Bonds
3) Buildings
4) Property
5) Trucks, Autos, Tools, Computers, etc.
6) Inventory

One of the major barriers to starting a new business, and the one most difficult to overcome, is finding capital. If you are inexperienced with borrowing procedures, you can often feel frustrated and bitter with the end results.

While there are several funding sources available for new business ventures, they all depend on one thing -- YOU! No matter who may be approached to invest in your business they will expect two things. First, they will expect that you have prepared a business plan. Second, they will expect you to be willing to invest your money and/or assets into the business, as well.

Before approaching any source for financing, there are a few questions that you must be ready to answer:

1) **How much money is needed?** You would be amazed at the number of business owners who approach a loan institution without a clue to how much money they need. The "how much will you loan me?" approach is doomed to failure, so we don't suggest you even attempt to use it. Also avoid the trap of asking for more money than you need because you think that, if the bank cuts you back to a smaller amount, you can still get by. Or worse, asking for less money than you need, thinking you can stretch it and make it work. What happens is that you look like you have no idea what your business needs are, which makes you a business risk.

There isn't a magic formula to determine the exact amount of capital you will need for your business. It will vary from business to business. The "type" of business you are entering into will cause still further variances. As a rule, the business that will require the most capital is a manufacturing business, while the least capital is generally required by consulting businesses. Service, restaurant and retail businesses would fall in between the two above.

The amount of capital required will also depend upon your own personal situation. If you live alone, and are dependent upon business revenue, it is vastly different than if you are supported by a spouse and, therefore, not totally dependent upon your business. Your living standard will also have an immense impact on your overall decision.

The one thing about capital that can be said with a degree of certainty is that it will take more than you think it will. Be thorough in your analysis. Ask only for the amount of capital you actually need, but make certain what you ask for is enough to do what you need it for.

2) **What will the money be used for?** There are generally four things that loans are used for:

a. buying new assets
b. paying expenses to create new revenue
c . paying off old debts and
d. substituting debt for equity in the business

The answer to this question will help determine the type of loan most likely to best suit your needs. The purpose for which the funds are to be used is an important factor in deciding the kind of money needed: Short term, long term, equity capital, etc., and how the loan will be handled: Secured, unsecured, etc.

Short-term loans are repaid from the liquidation of assets which have been financed. You can use them for purposes such as financing accounts receivable for, say 30 to 60 days. Or you can use them for purposes that take longer to pay off; such as building up a seasonal inventory over a period of time. Generally lenders expect short-term loans to be repaid once their purposes have been served. For example, for accounts receivable loans, when outstanding accounts have been paid by the borrower's customers, and with inventory loans, when the inventory has been converted into merchandise.

Unsecured loans are frequently used for short-term lines of credit. In these instances you are not required to put up collateral against the note.

Secured loans involve a pledge of some or all of the business's assets. The lender requires security as a protection against the risks that are involved even in business situations where the chances of success are good.

A final word. **There are no free government grants for small business within the state of Oklahoma at this time.** Television and newspaper ads claiming that Uncle Sam has "thousands of free dollars" to give away in loans, are some- what true. However, they fail to disclose that these funds are often geared toward specific populations, industries, or areas of the country. No free blanket funding currently exists. Funds, once available for minority and women owned businesses, have for all intents and purposes dried up since these two populations boast the largest growth in small businesses in the past few years.

A few private foundations do have grants available, but they are generally made available to only nonprofit organizations which are tax exempt under the IRS code 501 (c) 3. It is extremely rare that a foundation will donate to a for profit business and, when they do, it is for extremely focused projects.

There may be some grant funds available for innovation and research under the Small Business Innovation Research (SBIR) grant. However, the specifications for obtaining these funds are extremely stringent. For more infoarmation, contact:

The Oklahoma Center for the Advancement of
Science and Technology
4545 N. Lincoln Blvd. Ste. 116
Oklahoma City, Oklahoma 73105-3413
Toll Free: 1-800-265-2215
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4) ***History of the Firim*** *summarizing significant financial and organizational milestones and containing a description of employees, an explanation of banking relationships, a recounting of major services or products, etc.*

5) ***Description of Products/Services*** *in terms of what the business offers.*

6) ***Financial Statements*** *for the past few years and pro formal projections for the next 3 to 5 years, showing the effect anticipated if the project is undertaken and if the financing is secured.*

7) ***Capitalization*** *list of shareholders, how much is invested to date, and in what form.*

8) ***Biographical Sketches*** *of key players in the business.*

9) ***Principal Supplier and Customers.***

10) ***Problems and Other Pertinent Information*** *in terms of a candid discussion of any contingent liabilities, pending litigation, tax or patent difficulties, and any other contingencies that might affect the project your are proposing.*

11) ***Advantages*** *in terms of a discussion of what is special about the company, its products and services, marketing plans, or channels that gives the project a unique leverage.*

Angels. Angels are investors who will invest for a piece of the company or form a limited partnership because of possible percentage rate of return. The SBA sponsors The Angel Capital Electronic Network (ACE-Net). Its purpose is to link benefit from ACE-Net are those that:

1) Are looking for $250,000 to $5 million of equity financing from accredited investors who bring experience; and will be an active part of the management team of the company as well as bring dollars to the venture;

2) Are starting or managing ventures with the potential for generating substantial capaital gains which allow investors out of the company in three to five years.

3) Need early stage financing or smaller amounts of financing than can typically be raised.

Long-term loans provide money you pay back over a long period of time. It is broken down into two forms:

- *Intermediate - - loans longer than one year but less than 5 or*
- *Long-term - - loans for more than five years*

These types of loans are generally repaid from the profits of the business.

Equity capital involves taking people into your business who are willing to risk their money in it. They are primarily interested in potential income rather than in an immediate return on the investment.

3) **Why is the loan good for your business?** Lenders like to make "productive loans" that result in:

a. higher volumes or better margins
b. reduced costs, or
c. more profit

Whether your answer is one of the above, or something else altogether, you must be able to document, in detail, how and why your company would benefit from the suggested loan.

4) **Why do you need a loan to accomplish your goals?** The answer to this question is obvious if you intend to use the money to purchase things such as equipment, inventory, supplies, etc. Most lenders understand that small business's rarely have the "up-front" money needed to make large purchases of this nature. As long as you can clearly show how your purchases will benefit the business AND allow you to pay back the loan in a timely fashion, your chances for loan approval remain fairly good. It becomes more difficult to answer this question, however, if you intend to use the loan to pay off existing inventory. Most lenders believe that inventory should be paid by cash flow and are hesitant to make loans for this purpose. The possible exception to this rule is during seasonal peaks. However, if your answer to the question is to consolidate existing debt, you may have a problem. Lenders are hesitant to loan for this reason. The question in their mind is "if you can't pay these debts now, why should I believe you can pay the loan in the future?" You will have a much harder sell to make and your documentation will have to be flawless.

5) **When will you repay the loan?** Your lender's judgment of your business's ability to repay and the type of loan you need will be a deciding factor in the answer to this question. Another part of the answer depends upon "what" you are using the loan for and "how much" you intend to borrow. Certain types of loans are, by necessity, short-term. This is particularly true of loans for purchase inventory. Lenders who agree to such loans will generally require repayment within a short period period of time (60 to 90 days). However, if you are using the loan to purchase a building, the lender may allow a long-term note. A lot of the answer to this question lies within your cash flow projections. Cash flows are more than just profit and loss statements. They trace the business's money as it comes in and goes out and clearly shows when (and if) excess cash is available to pay off the loan.

6) **How will you pay back the loan?** Again, the answer to this question may lie in "what" you are using the money for. If you are, for example, purchasing seasonal inventory, you may be able to document how sales will allow you to repay the loan in a timely fashion. If you have a purchase order for a sale, which is dependent upon additional inventory, you can show that as a means to repay the loan. It becomes more difficult to answer this question, however, when you are involved in a long-term loan. In this instance, you must sell the lender on the earning power of the business. If you haven't done thorough research you will not be able to accomplish this. Only a solidly witten, completely thought-out, and viable business plan can achieve the proper answer to this queston in that instance.

7) **Is the cushion in the loan large enough?** In other words, does the amount requested make suitable allowance for unexpected developments? Your lender may make a determination of this based upon the financial statements you provide within your business plan.

8) **What is the outlook for business in general and for your business in particular?** The answer to this question is somewhat subjective in nature in that it may not be specifically clear cut. On the other hand, if your business is a yogurt shop and research indicates that such shops have shown a spiral downward over the course of a period of time, you would have a hard time justifying starting the business. An inability to answer this question indicates that you have failed to do your research. Therefore, this can be a sticking point in the loan process.

9) **What will you use for collateral?** Typical types of collateral security include:

Endorsers, co-makers, and guarantors. *Borrowers often get other people to sign a note in order to bolster their credit. These endorsers are contingently liable for the note. If the borrower fails to pay up, the bank expects the endorser to make the note good. A co-maker is someone who creates an obligation jointly with*

There are a variety of types of venture capital firms. They include:

*1) **Traditional partnerships** which are often established by wealthy families to aggressively manage a portion of their funds by investing in small companies;*

*2) **Professionally managed pools** which are made up of institutional money and which operate like the traditional partnerships;*

*3) **Investment banking firms** which usually trade in more established securities, but occasionally form investor syndicates for venture proposals;*

*4) **Insurance companies** which often have required a portion of equity as a condition of their loans to smaller companies as protection against inflation;*

*5) **Manufacturing companies** which have sometimes looked upon investing in smaller companies as a means of supplementing their R&D programs; and*

*6) **Small Business Investment Corporations (SBIC's)** which are licensed by the Small Business Administration and which may provide management assistance as well as venture capital.*

There are several key elements to an effective venture proposal. These include:

1) Statement of Purpose and Objective *that summarized the "what and why" of the project;*

2) Proposed Financing Requirements *that outline the amount of money needed from the beginning to the maturity of the project proposed, how the proceeds will be used, how you plan to structure the financing, and why the amount designated is requested.*

3) Marketing Description *of the market segment the business has or plans to obtain, a summary of the competition, the characteristics of the market, and your plans for getting or holding the market segment aimed at.*

*2) **Control.** Control is a much simpler issue to resolve. Unlike the division of equity over which the parties are bound to disagree, control is an issue in which they have a common interest. While it is understandable that the management of a small company will have some anxiety in this area, the partners of a venture firm have little interest in assuming total control of the business. They have neither the technical expertise nor the managerial personnel to run a number of small companies in diverse industries. They much prefer to leave operating control to the existing management. The venture firm does, however, want to participate in any strategic decisions that might change the basic product/market character of the company and in any major investment decisions that might divert or deplete the financial resources of the company. They will, therefore, generally ask that at least one partner be made a director of the company.*

Venture firms also want the option to assume control in an attempt to rescue their investments, if severe financial, operating, or marketing problems develop. Thus, they will usually include protective covenants in their equity financing agreements to permit them to take control and appoint new officers if financial performance is poor.

*3) **Annual Charges.** The investment of the venture capital firm may be in the final form of direct stock ownership which does not impose fixed charges. More likely, it will be in an interim form of convertible debentures or preferred stock. Financing may also be straight loans with options or warrants that can be converted to a future equity position at a pre-established price.*

*4) **Objective.** Venture capital firms generally intend to realize capital gains on their investments by providing for a stock buy-back by the small firm, by arranging a public offering of stock of the company invested in, or by providing for a merger with a larger firm that has publicly traded stock. They usually hope to do this within five to seven years of their initial investment.*

Most equity financing agreements include provisions guaranteeing that the venture capital firm may participate in any stock sale or approve any merger, regardless of their percentage of stock ownership. Sometimes the agreement will require that the management work toward an eventual stock sale or merger. Clearly, the owner of the small company seeking equity financing must consider the future impact upon his or her own stock holdings and personal objectives, since taking in a venture capitalist firm virtually commits to a sell out or public offering.

the borrower. In such cases, the lender can collect directly from either the maker or the co-maker. A guarantor is one who guarantees the payment of a note by signing a guaranty commitment. Both private and government lenders often require guarantees from officers of corporations in order to assure continuity of effective management. Sometimes, a manufacturer will act as a guarantor for customers.

***Assignment of Leases.** The assigned lease is offered as security in a similar manner as a guarantor. The lender lends the money on a building and takes a mortgage. Then the lease, which the dealer and the parent franchise company work out, is assigned so that the lender automatically receives the rent payments. In this manner, the bank is guaranteed repayment of the loan.*

***Warehouse Receipts.** Some lenders take commodities as security by lending money on a warehouse receipt. The receipt is usually delivered directly to the lender and shows that the merchandise used as security has either been placed in a public warehouse or has been left on your premises under the control of an employee who is bonded. Such loans are often made on staple or standard merchandise which can be readily marketed. The typical warehouse receipt loan is for a percentage of the estimated value of the goods used as security.*

***Trust Receipts and Floor Planning.** Merchandise, such as automobiles, appliances, and boats, have to be displayed in order to be sold. The only way many small marketers can afford such displays is by borrowing money. Loans in this instance are often secured by a note and a trust receipt.*

***Real Estate.** Real estate is another form of collateral for long-term loans. When taking a real estate mortgage, the lender finds out the location of the real estate, its physical condition, its foreclosure value, and the amount of insurance carried on the property. (S)he then assigns a value to the property. Loans are made against that value amount.*

***Accounts Receivable.** Some lenders are willing to lend money on accounts receivable. In effect, you are counting on your customers to pay your note. The bank may take accounts receivable on a notification or a nonnotification plan. Under the notification plan, the purchaser of the goods is informed by the lender that his or her accounts have been assigned to it and he or she is asked to pay that lender. Under the nonnotification plan, the borrower's customers continue to pay the business who, in turn, makes the payment to the lender.*

Savings Accounts. *Sometimes, you can get a loan by assigning to the lender a savings account. In such cases, the lender typically keeps your savings passbook.*

Life Insurance. *Another kind of collateral is life insurance. Lenders will lend up to the cash value of a life insurance policy. You have to assign the policy to the lender. If the policy is on the life of an executive of a small corporation, corporate resolutions must be made authorizing the assignment. Most insurance companies allow you to sign the policy back to the original beneficiary when the assignment to the bank ends. Some people like to use life insurance as collateral rather than borrow directly from insurance companies. One reason is that a loan is often more convenient to obtain and usually may be obtained at a lower interest rate.*

Stocks & Bonds. *If you use stocks and bonds as collateral, they must be marketable. As a protection against market declines and possible expenses of liquidation, lenders usually lend no more than 70 percent of the market value of high grade stock. On federal government or municipal bonds, they may be willing to lend 90 percent or more of the market value. The lender may ask the borrower for additional security or payment whenever the market value of the stocks or bonds drops below the bank's required margin.*

10) **What happens if the business fails?** The obvious answer to this question is that the lender can collect on the collateral; those assets pledged to the lender that cover the amount of the loan. A shrewd lender, however, will tell you that collateral rarely actually covers the loan. The reason behind this is that lenders, who are not in the business of selling collateral, must often liquidate it in a hurry. In doing so, collateral is generally sold at a cost lower than its actual value.

If you, however, as the borrower, can show the how and where the collateral you offer can be liquidated at a cost equal to its value against the loan, you are one step ahead of the game. It demonstrates that you have done your home work, thought through the entire process, and considered all of the consequences. That makes you a much better business risk!

1) ***Ownership.*** *Venture capital financing is not inexpensive for the small business owner. The partners of the venture firm buy a portion of the business's equity in exchange for their investment. This percentage of equity varies and depends upon the amount of money provided, the success and worth of the business, and the anticipated investment return. It can range from 10 to as much as 80 or 90 percent for beginning or financially troubled firms. Initially, most venture capital firms do not want a position of more than 30 to 40 percent of the business because they want the owner to have the incentive to keep building the business. If and when additional financing is required to support the business's growth, the outsiders' stake may exceed 50 percent. However, investors realize that small business owners may lose their entrepreneurial zeal under those circumstances so it is a step they hope to avoid. In the final analysis, however, the venture firm - - regardless of its percentage of ownership - - really wants to leave control in the hands of the company's managers, because it is that team it invested in the first place.*

Most venture firms determine the ratio of funds provided to equity requested by a comparison of the present financial worth of the contributions made by each of the parities involved. The present value of the contribution of a starting or financially troubled business is obviously rated low. Often it is estimated as the existing value of his or her idea and the competitive costs of the owner's time. The contribution by the owners of a thriving business is valued much higher. Generally, it is capitalized at a multiple of the current earnings and/or net worth.

Financial evaluation is not an exact science. The final compromise on the owner's contribution's worth in the equity financing agreement is likely to be much lower than the owner thinks it should be and considerably higher than the partners of the venture capital firm think it might be. In the ideal situation, of course, the two partners are able to do together what neither could do, separately. The company is able to grow fast enough with the additional funds to do more than overcome the owner's loss of equity and the investment grows at a sufficient rate to compensate the venture capitalist for assuming the risk.

Most venture capital firms are interested in projects requiring an investment of $250,000 to over $1 million. Projects smaller than that are of limited interest because of the high cost of investigation and administration. However, some venture capitalists will consider smaller projects if the investment is sufficiently intriguing.

The typical venture capital firm receives over 1,000 proposals each year. Over 90 percent of the proposals are rejected because they have been poorly prepared. The remaining 10 percent are investigated with great care. These investigations are expensive since firms typically hire consultants to evaluate the product(s) - - particularly when it is the result of innovation or it is technologically complex. The market size and competitive position of the company are analyzed by contacts with present and potential customers, suppliers, and others. Production costs are reviewed. The financial condition of the company is confirmed by an auditor. The legal form and registration of the business are checked. Most importantly, the character and competence of the management is evaluated, through an extensive background check. These preliminary investigations may cost a venture firm between $2,000 and $3,000 per company. They result in perhaps 10 to 15 proposals of interest. Then, second investigations which are even more thorough are run. These investigations typically reduce the number of proposals under consideration to three or four. Eventually the firm invests in one or two of these.

When a venture capital firm decides to invest in a project, it will typically prepare an equity financing agreement that details the amount of money to be provided, the percentage of common stock to be surrendered in exchange for these funds, the interim financing method to be used, and the protective covenants to be included. This proposal will then be discussed with the management of the company to be financed. The final financing agreement will be negotiated and generally represents a compromise between the management of the company and the venture firm. The important elements of this compromise are:

As noted earlier, all lenders require a business plan. In addition to the standard requirements, the plan should clearly outline your personal, as well as your business finances. These help potential lenders evaluate your life-style to see if it is supportable and realistic. If the business is to be your sole source of income, it is imperative to determine whether or not the business will earn sufficient profits to repay all or your debts. In addition to disclosing your personal debts, you may be asked to provide a list of your personal assets. The list should include all savings account funds, stocks, bonds, income producing real estate, or other "real worth" assets. As a rule you should not include such things as furniture, jewelry, or other items of personal value but which would not be acceptable as collateral. A realistic value or actual market value should be shown for each asset.

What are you willing to invest in the business?

Lenders will also be interested in your commitment to the business. This may be money you put into the business; your time, effort, talent, and skills; or it may be all of these things.

Finally, you should be aware that potential lenders will closely examine three C's before making a final determination on a loan. These are:

1) **Character/Credit.** Lenders often conduct both personal and commercial credit checks on potential borrowers. The purpose behind these checks is to determine the lender's risk in making the loan. They want, and have every right, to know your previous payment record. This helps them understand what kind of credit risk you are.

2) **Capacity.** The focus here is on talent, skill, education, and business background with an intent to determine the likelihood of your success in the business venture. A business resume which outlines your business skills and technical knowledge, along with your education and experience, will be helpful. Beyond that, you must also show that you have taken into consideration a lot of the "what ifs?" of business such as: What events or trends will hurt your business and what if more competition is generated? Potential lenders will ask these kinds of probing questions. You must have the answers.

3) **Capital.** We've talked about the collateral you may offer against a loan. Here is where you must explain how that collateral equates to money. It also gives you an opportunity to explain other money you, as the owner, may be willing to invest. This also helps potential lenders measure your level of commitment to the business. Business collateral such as equipment, furnishings, inventory, and supplies, for instance, that you may have already purchased, counts as capital that you have invested in your business and they represent important information to potential lenders.

Lending institutions are not just interested in loan repayments. They are also interested in borrowers with a healthy and profit-making businesses. They may set loan limitations and restrictions in order to protect themselves against unnecessary risk and at the same time against poor management practices by their borrowers. Some owners consider such loan limitations a burden. Others, on the other hand, feel that such limitations offer an opportunity to improve their management techniques.

Particularly with regard to making long-term loans, the borrower as well as the lender should be thinking of the:

1) Net earning power of the business
2) Capability of the business's management
3) Long-range prospects of the business; and
4) Long range prospects of the industry.

Such factors often mean that limitations increase as the duration of the loan increases. Such limitations could include:

1) Repayment terms
2) Pledging or the use of security; and/or
3) Periodic reporting

With all of these requirements, you may be wondering "if" you even want to approach a lender. But the fact is, unless you have another mechanism to raise money, borrowing may be you most viable option. There are several borrowing options:

The ability of a business to repay a loan through cash flow is one of the most important considerations of SBA's loan making policy. Another critical factor is management experience. In many loan officer's minds it is the most important issue in evaluating the applicant's potential for success. The SBA relies heavily on proof of experience in the business plan.

Applications for any SBA guaranteed loan must be accompanied by a written business plan.

Other Funding Options

SBA licensed investment companies. Small Business Investment Companies (SBICs) and Minority Enterprise Small Business Investment Companies (MSBICs) make venture-risk investments, supplying equity capital to secure loans to qualified small enterprises.

Venture capitalists. A venture capitalist generally wants to invest in the ownership of a business that will generate tremendous growth in a short period of time, for which he or she will be highly rewarded. Typically these individuals will expect that the business to go public (to trade company stock on the public market) in about three to five years and, as a rule, they want to see a large deal with a very strong experience on the part of the business person. For this reason, these risk takers usually specialize in related industries and prefer making loans to companies that are at least three to five years old and have shown high growth potential with higher-than-average profits for their shareholders.

Venture capitalists often claim the right to participate in management of the business. If the company does not perform at the anticipated level, they may become active in the overall decision-making process as well.

Dun and Bradstreet reports that recent bank failures have been at an all-time high. Business bankruptcies have also been breaking records. Therefore, banks today have become very conservative in the way they approach business loans. While they are still lending money, it is mainly to clients that can meet strict criteria and who have demonstrated background experience. Specifically, banks will look closely at the following before considering a loan either to an existing business or a new venture:

a. how long do you want the loan to run?
b. what will the money be used for?
c. will the business be able to pay back the loan?
d. is collateral sufficient to pay back the loan in case of default?
e. do you have a business plan?
f. what is your personal financial statement?

3) **SBA Guaranteed Programs.** SBA loans are made by private lenders under a SBA "guaranty." The lender plays the central role in the delivery system. The business submits the loan application to the lender, who makes the initial review, and, approves it for submission to SBA. If approved by the SBA, the lender closes the loan and disburses the funds.

Loan maturities on any SBA loan must be commensurate with the ability of the business to repay, the useful life of the assets financed, and the use of proceeds. However, the following guidelines should help you determine whether this type of loan will work for your business

SBA loans:
a. for working capital typically do not exceed seven years;

b. for fixed assets other than real estate will be limited to the economic life of those assets; not to exceed 25 years; and

c. for real estate is typically 25 years, including business premises that are to be constructed, renovated, or refinanced.

SBA evaluates an applicant's ability to service the debt. Each application must contain a credit report. Another major factor in making loan decisions is the ability of the business to pay. This will be evaluated through the historical pro forma financial statements and/or future cash flow projections.

1) **Friends or Relatives.** Borrowing from a friend or relative is often the most readily available source of capital. This is particularly true when money needs are small. However, while this is the least expensive way to raise capital - - in terms of dollars - - it can be the most expensive way, in terms of personal relationships. For this reason, enter into this type of arrangement with a great deal of caution. Consider some kind of contract that spells out the specific terms of the loan.

2) **Banks.** Banks are in business to make profitable loans. They do this by lending deposits to businesses which satisfy their standards and criteria. While this differs from bank to bank, they all look for the same things (many of which we have previously discussed):

a. the amount of money required
b. the purpose of the loan
c. the source of repaymen
d. the availability of collateral
e. your experience and expertise in the business
f. competition in the business you are going into; and
g. your credit records, etc

For these institutions, the length of a loan will primarily be determined by the purpose for which the funds are to be used. Loans are broadly classified as short-term for items like inventory, accounts receivable, etc. Long-term or term loans are available for purchases of real estate, machinery, and equipment.

To secure a loan in the event of default, the bank will look to the collateral offered. Where there are sufficient assets in the business, a lien on those assets may satisfy the bankers' requirement. If there aren't sufficient business assets, the bank will require personal collateral (e.g., bonds, stocks, etc.). As a rule, the bank will require more collateral than the amount of the loan. How much more depends upon the type of loan, the collateral being offered, and whether or not the loan is guaranteed. Collateral requirements may be made easier if a secondary source of repayment for a loan can be offered such as a guarantee. The personal net worth of a guarantor must, as a rule, be substantive and verifiable documentation must be offered to the bank.

Bank loans require corporations to have the signature of the authorized corporate officer(s) along with their personal guarantee of the note. All partners borrowing money are also required to sign loan documents. In the case of sole proprietors, banks nearly always require both the husband and wife to execute loan applications.

Your personal investment in the business will be important to the banker in deciding whether or not you are a qualified borrower. He will expect you to invest between 20 and 40 percent of the total amount required to start the business. Banks prefer that such equity injection be cash. But in some instances they will accept in-kind equity like a van, computer, or other equipment you already own which will be used in the business. If you have certificates of deposit or other investments, consider the consequences of using these assets as collateral. The spread between interest earned and the interest cost to borrow when using them as collateral may make cashing them in a better decision.

Although you will be negotiating a business debt by making a business loan, your personal finances will have an important bearing on your banker's decision. A list of personal debts indicating monthly payments and the date when each debt will be fully paid should be prepared. These typically include home, car, boat, or other personal loans. If you have borrowed the equity capital you are investing in your business this should be included on your list. Failure to reveal all such information to the bank can lead to dire consequences. You should also prepare a schedule of your assets. The bank will be interested in knowing what bonds, stocks, income producing real estate or other assets of value you own. Finally, a personal budget of living expenses should be prepared. If these funds will be drawn from the business, it is mandatory that you include the amount required each week or month in the budget for business operating expenses.

Adequate provision for personal living expenses must be allowed for since failure to do so can result in serious problems. In addition to immediate personal obligations, near term obligations such as sending a child to college should be factored into your personal needs and show what provision have been made for these additional near-term needs.

Misrepresentation of personal financial needs is self-defeating and technically illegal. Credit availability is one of your most important assets. Failure to meet credit card payments or any payment when due will seriously impair your credit. Furthermore the interest rates of 14 to 15 percent and as high as 18 or 19 percent and even higher will add to an already serious financial problem if you have relied heavily upon the use of credit cards.

Pending law suits or judgments against you should be revealed. Whether it is for product liability, personal injury, or whatever, it should be listed along with any insurance you may have to cover the lawsuit.

Similarly, the bank will be interested to know of any pending tax problems at the federal, state, or local level. Your chance of getting a bank loan can be seriously placed in jeopardy by tax problems, however, you are legally obligated to reveal to the bank any problems whether they stem from personal or business taxes.

Whether you hire professional assistance or do your own business plan, you must be totally familiar with both the narrative and the financials. Too often cash flow, and profit and loss statements are based on overly optimistic projections.

The banker examining your business plan understands financial statements and profit potential based upon the capital in the business and the volume of sales potential. In justifying your financials, be prepared to justify operating expenses. If rent is high, is it because your business requires a prime location? If salaries are high, is it the amount you expect to draw each week or are you in a high labor market or labor intensive business? It is important that you be able to explain and justify every line item of expense.

Banks usually require that borrowers carry sufficient life insurance to cover the loan. This may be done in several ways. If you now carry life insurance in a sufficient amount, an assignment if the policy to the bank should suffice and you will not incur any additional expenses. If the policy is larger than the amount, in the event of the death of the borrower, the bank will be entitled to receive only the amount of the loan and any unpaid interest. If the policy is less than the loan, or the borrower has no insurance, it will have to be purchased. This may be done either through the bank, an independent agent, or an insurance broker. Since monthly payments will serve to decrease the amount of the loan, the amount of insurance purchased should be coordinated as closely as possible with the balance of the loan at the end of each year. Decreasing term insurance, the cheapest form of life insurance is usually purchased for loan insurance. It is suggested you compare the cost of bank insurance with that of the independent insurance agent or broker of your choice.