

Funding your Business:

Navigating Funding Readiness for Arizona Entrepreneurs

Presented through The State Small Business Credit Initiative (SSBCI)

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State Small Business Credit Initiative (SSBCI) Technical Assistance (TA):

This presentation is part of the SSBCI TA program that assists SEDI (Socially and Economically Disadvantaged Individuals) and VSB (Very Small Business) beneficiaries with financial literacy training for the outcome of **securing funding**.

This presentation will assist new and seasoned business owners with education, options and a roadmap for future business funding.

Loan Guarantees and SSBCI

SSBCI initiative also includes a loan guarantee component which can be very helpful in some cases where applicants are close but “not quite there” for an approval.

A loan guarantee is a legally binding agreement where a third party, known as the guarantor, promises to pay off a borrower's debt if the borrower defaults. The guarantor can be liable for the entire debt or just a portion of it, depending on the terms of the guarantee.

Business Financing

The process of funding business activities, purchases, or investments.

Also referred to as “access to capital”



It is common that new businesses start and, at least for a certain time, develop with *little or no external funding*.

Eventually, however, financing will be required.

That is exactly what we will discuss today:
Business Financing

A basic classification of ways to finance a business:

Equity Financing:

- Angel Investors
- Venture Capital firms
- Corporate Investors
- Partnering with friends/family

Debt Financing:

- **Bank/Financial Institutions loans**
- Invoice Factoring
- Crowdfunding
- Personal loans from family and friends

Essential Stages of a Loan Application

While the names of stages may differ by lending institution, we can break the loan process into three stages:

- **Application**
 - Provide all information and documents (Taxes, P&L, Business Info)
- **Underwriting Process**
 - Loan is reviewed against lender guidelines
- **Loan Closing**
 - Conditions met and documents signed



What do lending institutions look at when reviewing and underwriting your loan application?

This can be better explained – and understood - through the “Five Cs of Credit”, which include Capacity, Capital, Conditions, Character, and Collateral.

Let’s check each one of them!

Capacity (Cash Flow)

Lenders must be sure that the borrower has the ability to repay the loan based on the proposed amount and terms, so they look at your “capacity” to borrow.

- Review Current P&L Statement and Balance Sheet
- Review Additional/Outside income
- Debt Service Coverage and other ratios
- Understanding Other Debt Obligations (Balance Sheet)
- Future Projections (why do we need these?)
- Not putting undue stress on the business

Capital

Lenders also analyze a borrower's capital level when determining creditworthiness. “Capital” for a business-loan application consists of personal investment into the firm, retained earnings, and other assets controlled by the business owner.

- Personal Investment (Capital Injection)
- Retained earnings (Cumulative net earnings or profits of a company after accounting for dividends or owner draws)
- “What is your skin in the game?” – When an owner is fully vested into their company there is an added incentive to give it 110% and not default on their obligation to the lender

Conditions

“Conditions” refer to the terms of the loan itself, as well as an economic conditions that might affect the borrower.

- Strengths and Weaknesses (Overall economy and purpose of loan)
- Uses of Funds – “Does your loan request make sense?”
- This factor is the most subjective of the 5 C’s and is evaluated mostly qualitatively. Industry related – “Is your industry considered HIGH RISK?”
- Terms – Interest Rate, Term of Loan, Payment, etc. (Payments affect cash flow)

Character (Credit)

“Character” refers to a borrower’s reputation or record regarding financial matters. The old adage that “past behavior is the best predictor of future behavior” is one that lenders subscribe to.

- Verifying references (Personal and Business)
- Credit Score – “Knowing your score is crucial in any conversation with a lender”. Most lenders require a Personal Guarantee and review personal credit.
- Bankruptcy – What type?
- Collections/Charge offs – (Medical Debt, Repossessions)
- Credit Usage – “Are you maxed out on credit card debt?”

Collateral

Personal/Business assets pledged by the borrower as a security interest for their loan.
“Collateral” can come in many forms.

- Real Estate – Residential or Commercial
- Equipment – Tractor, Industrial machinery, Vehicles (included Dump trucks, semi-trucks, Heavy duties)
- Lenders measure collateral quantitatively by its value and qualitatively by its perceived ease of liquidation
- Default? Collateral helps mitigate the perceived risk with any loan. The better the collateral the stronger the application

Now that we have a good understanding of what financial institutions look at when receiving a loan application, are we ready to apply?

It is possible; however, it is extremely important that we also get familiar with the “Capital Readiness” concept, or, in the world of business lenders, “Loan Readiness”. Let’s see that now.

Loan Readiness

“**Loan ready**” is a qualification in relation to a business's financial health and creditworthiness. If we say a business is “loan ready”, we mean that the business is eligible to apply for a loan. *It is certainly not a guarantee of approval*, but it should be considered as the first step in the right direction.

“**Loan readiness assessment**” is the process of evaluating readiness. It is not necessarily a formal procedure. However, it is always done, and most of the time it is done through conversation.



Small Business Owners and Borrowing

Many people who run very small businesses or who are just starting out believe that a loan can fix any problem they encounter. But the truth is, more money isn't always the answer.

Ideally, a loan should be used for:



Growth/
expansion
projects



To take advantage
of new
opportunities
offered by
markets



The purchase of
equipment or
other needed
supplies and
inventory.

Important things to keep in mind about taking on business debt



A bad loan, a loan where the borrower ends up defaulting, is not only damaging for the lender, but also for the borrower. The road to recovery can be long and very difficult.



We should embrace initial loan readiness assessments and advice offered by financial institutions staff as something helpful and as part of their service. If a loan is possible, they will help you find the way!

What small businesses can expect when talking to a lender or other staff at financial institutions

First, you need to *be ready* and handle those initial conversations with the mentality that you are going through a loan readiness assessment. In other words, **preparation is the key**.

Understand that a lot of questions will be coming your way. You must *show patience* and answer in a straightforward, concise way, to the best of your ability.

Technical Assistance offering like help w/Business Plans&Projections

The Do's & Don'ts of Loan Readiness Assessments

What helps our cause:

- ✓ Show patience and understanding. Approach the conversation calmly and be open to the process.
- ✓ Keep your answers straightforward and consistent. Avoid giving conflicting information.
- ✓ Remember: Lenders are on your side. They're looking to give out loans, so if there's a way to approve your loan, they'll work towards it.
- ✓ Have all your business information ready to show. Whether it's on paper or digital, make sure it's well-organized and easy to understand.
- ✓ Keep in mind that a business loan is by nature something more complicated than a consumer loan, avoid comparing it with CC/Auto loans.

The Do's & Don'ts of Loan Readiness Assessments

What does not help, or hurt our cause:

- ✓ Not having an **express purpose** for your loan request and not having a **very good estimation** of the amount you need based in the business project
- ✓ Show that you are in a hurry, and you do not consider the conversation important
- ✓ Assuming and/or expressing that the “system” always works against you
- ✓ Not being clear in your answers, **too many “if and buts” and obvious contradictions.**
- ✓ Not being prepared, not having information on hand or having it in a very disorganized way.

Additional Preparation:

- Be able to explain with detail what you need the money for. Understand how much you need and **be prepared to justify how you calculated that amount.**
- Match your excitement with the real details of your project. **Keep it realistic** and stay away from overstating or guessing outcomes.
- Remember that the loan process can take several weeks or even months depending on your lender. Preparation and patience are key. **It is important to start the process way before you actually need the financing.**

Other important notes

- Remember, business loans are usually not granted for covering overdue expenses like back rent or late payroll.
- Remember that it will be highly probable that **you will be asked to be a personal guarantor** of your business loan. This is common on most loans.
- You might also need to **contribute your own funds to the business** – this shows lenders you're committed.
- Keep your financial documents, like Profit and Loss statements and Balance Sheets, up-to-date and ready to share.

Next Steps and Resources for Capital Readiness



Businesses can apply for ***no-cost*** technical assistance through the ACA website at <https://www.azcommerce.com/ssbci/sbci-technical-assistance-grant-program/>



Learn more about the ACA SSBCI Loan Guarantee and Equity Programs by visiting the SSBCI Website at <https://www.azcommerce.com/ssbci/>

Questions ??

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