A Guide to Preparing to Borrow Capital For Your Business

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Guidelines When Preparing to Borrow

Whether it is for the start-up or growth phase, most businesses ultimately need to borrow money. Here are some issues to consider as you approach the borrowing process. Addressing them as you start the borrowing process can increase the chances of getting the loan and make the process much easier.

1. Reasons for Borrowing: Every potential lender will want to know the purpose of the loan. As with personal borrowing, potential lenders will look more favorably if the funds are going to be used to produce lasting value for the business. A loan to expand the business to meet the needs of a signed contract with a major customer will be more attractive to a lender than one where the proceeds would be used to meet ongoing operating payroll needs due to a slow down in the business.

Build a case for how the funds will enhance the short-term and long-term results of the business.

2. Borrowing From the Right Source: Be sure you have considered all of your alternative sources of capital before you go to a financial institution. While running up your credit card balances can be expensive and asking relatives for funds can be difficult, those alternatives may be preferable, especially if the loan is for a small amount or for a short period of time.

Are you approaching lenders that are accustomed to making loans to businesses of your size, in your industry, or in a specific geographic area? If the institution already knows you, your business, your industry, and potentially your customers, they may already have a great deal of the information they need to make an informed lending decision.

If you expect to use the funds to purchase a piece of equipment, you may want to discuss equipment leasing options with the equipment seller. Many manufacturers of machines (from office equipment to large industrial equipment) have leasing arrangements with lenders that may be familiar with your type of business.

You also need to consider whether your primary financial institution is the right lender to approach.

3. Type of Loan Sought: Does the repayment term of the loan match with your expected cash flow? For example, will receipts from your receivables enable you to meet the payment terms?

Be prepared to offer collateral that is tied to the purpose of the loan. Getting a loan to purchase a large new machine may require you to offer a security lien on the machine as collateral. Try to avoid pledging large amounts of collateral for relatively small loans.

Depending on the size of your business, you may want to investigate a Small Business Administration loan. The SBA encourages lending to small businesses by guaranteeing parts of loans made to businesses of certain sizes where the proceeds are being used for certain purposes. You can talk to an institution offering SBA loans to learn more. While the paperwork and time frames may be viewed as a burden, this may be an option to consider.
4. **Documentation Needed:** You will be required to complete a loan application, which will require corporate and perhaps personal financial information. In addition, you will probably need to provide:
   1. Tax returns for the business for the past couple of years
   2. Potentially, personal tax returns for the past couple of years
   3. Financial statements for the business for the past couple of years
   4. A year-to-date financial statement
   5. Both income statements and balance sheets
   6. Detailed information on accounts receivable, accounts payable, investments and fixed assets
   7. A historic cash flow statement along with projections for the current year
   8. The lender may also want copies of significant contracts with customers and vendors
   9. Other important information such as patents or key proprietary information

5. **Business Plan:** Your business plan should play a major role in your decision to borrow and may play a major role in a lender's evaluation of your loan request. The major components of the plan should include:
   1. Business description
   2. Marketing strategies
   3. Competitive analysis
   4. Development plans
   5. Operations
   6. Management plan
   7. Key personnel
   8. Financial information
   9. Other important information

Be sure your plan is up to date and provides all the information the lender will need to understand your business and make a fully informed lending decision.

6. **Business Practices:** Any lender will want to evaluate how you run your business, and you should be prepared to answer these questions:
   1. Do you have a credit policy? Is it enforced?
   2. Does your accounting system adequately show the condition and results of your business?
   3. What is your accounts payable policy? Do you negotiate favorable terms with key vendors prior to placing orders? How current are you with payables? Do you take advantage of discounts for prompt payment?
   4. What type of insurance coverage do you have? Is there adequate insurance for liability and property damages?

7. **Taxes:** Are all your payroll, property, and income tax filings current? Do you use the services of a qualified tax professional to help ensure that your tax benefits are maximized?

Borrowing money for your business is a serious step. Use the process of getting ready to borrow as a tool to evaluate your business and to plan for its success. The proper preparations can strengthen your business and strengthen your case for borrowing.