How to finance your business

The art of getting the money

http://india.smetoolkit.org

SME Toolkit India

This starts by knowing what your lender wants. A common way is to simply ask. A better way is to ask a friend or business advisor such as your CPA.

For a business loan, the most common things are:

- Business financial statements;
- Business tax returns;
- Business plan with budget or projection;
- Personal financial statements; and
- Personal tax returns.

Step two is to be ready to answer questions about your business, and be ready to highlight your financial performance both in the past and in the future. You will be more impressive if you have carefully thought-out and become familiar with your plan. Bring your accountant if you need help.

Be prepared to tell them why you need the money. "I just need the money," does not inspire confidence or the fact that you have thought it through. Earlier in this session you studied a number of different purposes. Give them some detail.

Propose a repayment plan. Examples of different structures are:

- A line of credit, payable at your discretion but subject to renewal annually by the bank; and
- Term loan payable monthly over ___ years starting on ____ date.

Most places have some flexibility. Potential lenders appreciate that you are thinking about paying them back instead of just getting the money.

Other tips to keep in mind:

- Needless to say, being well-dressed and neat in appearance at bank meetings will reflect positively.
- Most lenders (including the SBA) will want to see your business plan.
- Keep your lenders informed on the status of your business: the good and the bad.
- If you are unable to make a loan payment on time, call your lender in advance, advise him/her of the problem and request the extension you need. Explain the sources of repayment.
- Virtually all lenders will do a personal savings and corporate credit check through a company called TRW or other means. Be prepared to discuss any prior credit issues/problems. The best access to a lender is by a referral. Lending is a people business. Have your CPA or attorney or friend introduce you to a lender.
- The first thing that will spook lenders or investors is the fear you are "puff" rather than "substance." Avoid giving the impression of being an over optimistic, "pie-in-the-sky" operator.
- Most start-up businesses don't find a place for expensive entertaining. Your lenders will be more interested in knowing how their money is being used to grow your business.
- Do not depend on a bank to loan you money to start a business. Most small businesses are funded by personal savings.
- Make a shrewd appraisal to minimize your risks and to limit losses to a predetermined limit.
- Your suppliers and vendors can be sources of financing. For example, if you need an illuminated sign for your store front, the company you contract with to make the sign may provide financing so you can make monthly payments rather than pay cash. (They want your business.) Examples:
  - Longer payment terms;
  - Advertising and marketing assistance;
  - Furnishing or financing of equipment, signs or inventory; and
  - Advertising and promotional programmes.
- Bartering, which is to trade by exchange one commodity for another, can provide a source of financing. For example your advertisements in the local newspaper might be paid for by the bagels you make! ❐

Venture capitalists

How they invest their money

http://www.hkvca.com.hk

Hong Kong Venture Capital and Private Equity Association Ltd., Hong Kong, China

The investment process, from the initial evaluation stage to completion of documentation, usually takes a minimum of three to six months.

Initial evaluation

The request for financing, business plan (for companies already in operations) and audited financial statements must first be submitted to the venture capital firm which will then determine the merits of the proposal. During this process, many applications for funds will be turned down, as they do not fit into the venture capital firm's investment criteria.

Initial negotiation

Where a venture capitalist is interested in the project, he will discuss and negotiate the general terms and structure of the investment with the entrepreneur. He will then submit his recommendation to his Investment Committee for initial approval.

Due diligence

When the initial investment proposal is approved, a Memorandum of Understanding on the broad terms and structure will be agreed upon. It will be necessary at this stage for the venture capitalist to verify the facts and assumptions presented in the proposal. They will conduct further independent investigation on the product and its technology; the market and its competitors; and, the distribution network. Often the help of outside consultants and market research are sought. The financials plans are reviewed rigorously. During this process, full disclosure by the company is important, and the company's staff, suppliers, customers, banks, accountants and lawyers may be interviewed.

Final negotiation and completion

Many issues will be covered, but the key points may be:

Price: Using the data and insight obtained during the due diligence process, the venture capitalist will undertake a "valuation" of the company by application of price to earnings multiples, asset valuation and other required return calculations.

Structure: The decision will be made on the amount of investment and whether it should take the form of equity, quasi-equity or other hybrid instruments (common shares, preferred shares, convertible loans, warrants, options). In buyouts it is normal for a new company to be formed to acquire the assets and trading liabilities. Debt financing if available will be simultaneously injected into the transaction at completion.

Role: The extent of the venture capital investor's participation in the affairs of the company will be determined. This could involve representation at the board level, the appointment of a financial controller or other key management personnel, disclosure requirements, minority shareholders' protection and rights.

Upon formal approval of the investment by the venture capitalist's investment committee, legal documents will be prepared and signed. The shareholders' agreement will spell out the rights and obligations of both parties covering the terms of the investment, voting rights, sale arrangements, dividend policy, and venture capitalist's approval on matters that may affect the business plan.

Monitoring

The venture capital firm's representatives on the company's board will be able to participate actively on all major decisions. The venture capitalist will also monitor its investment closely through regular reviews of financials and operations with management. It is usual in buyouts that the venture capital firm will control the board of the company.

Exit

Venture capitalists typically exit the investment between 3-5 years after the investment date. Entrepreneur should be clear that venture capitalists require that an exit strategy be agreed with the entrepreneur before the investment is made and that this is constantly reviewed during the investment holding period. ❒