2975, boul. St-Charles, suite 255 Kirkland, (Qc) Canada H9H 3B5
Tel: 514-425-0412 Fax: 514-694-1125

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"This paper is intended to condense and present to the reader a practical guide to understanding sources of money. One key to successful business start-up and expansion is the ability to obtain and secure appropriate financing.

Raising capital is the most basic of all business activities. But as many entrepreneurs who are just beginning quickly discover, raising capital may not be easy. It can be a complex and frustrating process.

However, if you are informed, well prepared and planned effectively, raising money for your business will not be a painstaking experience. This report focuses on the ways a small business can raise money and describes how to prepare a loan proposal".

-- JOHN SHENTON, PRESIDENT

1 BUSINESS BASICS: UNDERSTANDING MONEY SOURCES

Never enough money! How many times have you said that? You need capital to get sales, buy inventory, pay your employees, purchase assets, pay taxes, you name it you need money for it. Expansion opportunities or a chance to purchase cost-saving equipment can also create a need for extra capital. Your need for capital never ends. To just stay in business or to expand, the small business owner needs capital, but where do you get it?

Raising funds in the private sector requires discipline, and a thorough knowledge of the rules of the game and the process. You should already know the first rule of raising money: The “Golden Rule” - he or she who has the “gold” makes the rules. The second rule: new money funds only new or expanding opportunities. New money does not solve old problems. With these ideas in mind, here are some thoughts on the best approach to raising money efficiently and effectively.

1.1 Project Time Line

There are no 30-day quick fixes from legitimate funding sources in the private placement market. This is due to the time required to prepare necessary documentation, market and attract potential investors, conduct due diligence, negotiate, and close the deal with the investors.

The normal time for completion of a private placement is approximately four months, assuming no complications or delays. Complications can arise from such sources as management control issues, legal, government regulatory, accounting, and operations.

The four-month project time line is divided in this manner:

- Preparation of a business plan...................................... 30-45 days
- Preparation of a Private Placement Memorandum......... 15-30 days
- Attracting potential investors.. 30 days
- Due diligence, final negotiations, and closing................ 30 days

There is quite a bit of overlap in preparing the business plan and the Private Placement Memorandum (“PPM”). A licensed securities attorney takes the business plan and incorporates many components into the PPM.

1.2 Available Sources

In order to secure the capital they need, small business owners must understand the various sources of money that are available to them such as the following:

- Capital generated internally.
- Capital available from trade creditors.
- Borrowed money.

- Sale of an ownership interest in the business to equity
- Investors.

Each of these capital sources has unique characteristics. These characteristics must be fully understood by the small business owner so that he or she will know what sources are available and which source is best suited to the needs of the business.

1.3 Report Objectives

This report has been designed to help the small business owner in the following ways:

- Recognize those situations that create a need for additional capital.
- Identify the capital sources that are available to the small business owner.
- Manage the business judiciously to take full advantage of the capital that can be generated internally.
- Establish a plan to permit the client to take full advantage of trade capital without jeopardizing credit status.
- Identify various specific sources of debt and equity capital.
- Identify collateral that can be used to secure loans.
- Identify potential compensation to equity investors such as opportunities for dividends, capital gains, or a future public offering that could attract equity capital.

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2 HOW THE NEED FOR CAPITAL ARISES

There is more than one way to skin a cat. You'd better remember this old adage when your business needs more inventory, personnel, and facilities. As your business grows, so does your need for more and more capital. Remember there is more than one way and more than one place to raise the money you need.

2.1 Causes of Additional Capital Needs

There are many factors that can create a need for additional capital. Some of the more common are as follows:

- Sales growth requires inventories to be built to support the higher sales level.
- Sales growth creates a larger volume of account receivable.
- Growth requires the business to carry larger cash balances in order to meet its current obligations to employees, trade creditors, and others.
- Expansion opportunities such as a decision to open a new branch, add a new product, or increase capacity.
- Cost savings opportunities such as equipment purchases that will lower production costs or reduce operating expenses.
- Opportunities to realize substantial savings by taking advantage of quantity discounts on purchases for inventory, or building inventories prior to a supplier's price increase.
- Seasonal factors, where inventories must be built before the selling season begins and receivables may not be collected until 30 to 60 days after the selling season ends.
- Current repayment of obligations or debts may require more cash than is immediately available.
- Local or national economic conditions which cause sales and profit to decline temporarily.
- Economic difficulties of customers that can cause them to pay more slowly than expected.
- Failure to retain sufficient earnings in the business.
- Inattention to asset management may have allowed inventories or accounts receivable to get out of hand.

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2.2 Combination

Frequently, the cause cannot be entirely attributed to any one of these factors, but results from a combination. For example, a growing, apparently successful business may find that it does not have sufficient cash on hand to meet a current debt installment or to expand to a new location because customers have been slow in paying.

2.3 Short and Long-Term Capital

Capital requirements can be classified as either short or long-term. Short-term needs are generally those of less than one year. Long-term needs are those of more than one year.

2.4 Short-term Financing

Short-term financing is most common for assets that turn over quickly such as accounts receivable or inventories. Seasonal businesses that must build inventories in anticipation of selling requirements and will not collect receivables until after the selling season often need short-term financing for the interim.

Contractors with substantial work-in-process inventories often need short-term financing until payment is received. Wholesalers and manufacturers with a major portion of their assets tied up in inventories and/or receivables also require short-term financing in anticipation of payments from customers.

2.5 Long-term Financing

Long-term financing is more often associated with the need for fixed assets such as property, plant, and equipment where the assets will be used in the business for several years. It is also a practical alternative in many situations where short-term financing requirements recur on a regular basis.

2.6 Recurring Needs

A series of short-term needs could often be more realistically viewed as a long-term need. The addition of long-term capital should eliminate the short-term needs and the crises that may occur if capital were not available to meet a short-term need.

2.7 Steady Growth

Whenever the need for additional capital grows continually without any significant pattern, as in the case of a company with steady sales and profit from year to year, long-term financing is probably more appropriate.

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3 INTERNAL FINANCING SOURCES

3.1 Internal vs. External

Internal sources of capital are those generated within the business. External sources of capital are those outside the business such as suppliers, lenders, and investors.

For example, a business can generate capital internally by accelerating collection of receivables, disposing of surplus inventories, retaining profit in the business, or cutting costs.

Capital can be generated externally by borrowing or locating investors who might be interested in buying a portion of the business.

3.2 Internal Financing Sources

Before seeking external sources of capital from investors or lenders, a business should thoroughly explore all reasonable sources for meeting its capital needs internally. Even if this effort fails to generate all of the needed capital, it can sharply reduce the external financing requirement, resulting in less interest expense, lower repayment obligations, and less sacrifice of control.

With a lower requirement, the business' ability to secure external financing will be improved. Further, the ability to generate maximum capital internally and to control operations will enhance the confidence of outside investors and lenders. With more confidence in the business and its management, lenders and investors will be more willing to commit their capital.

3.3 Basic Sources

Basically, there are three principal sources of internal capital. These are as follows:

- Increasing the amount of earnings kept in the business.
- Prudent asset management.
- Cost control.

3.4 Increased Earnings Retention

Many businesses are able to meet all of their capital needs through earnings retention. Each year, shareholders' dividends or partners' drawings are restricted so that the largest reasonable share of earnings is retained in the business to finance its growth.

As with other internal capital sources, earnings retention not only reduces any external capital requirement, but also affects the business' ability to secure external capital. Lenders are particularly concerned with the rate of earnings retention, since the ability to repay debt obligations normally depends upon the amount of cash generated through operations. If this cash is used excessively to pay dividends or to permit withdrawals by investors, the company's ability to meet its debt obligations will be threatened.

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3.5 Asset Management

Many businesses have non-productive assets that can be liquidated (sold or collected) to provide capital for short-term needs. A vigorous campaign of collecting outstanding receivables, with particular emphasis on amounts long outstanding, can often produce significant amounts of capital.

Similarly, inventories can be analyzed and those goods with relatively blow sales activity or with little hope for future fast movement can be liquidated. The liquidation can occur through sales to customers or through sales to wholesale outlets, as required.

3.5.1 Fixed Assets

Fixed assets can be sold to free cash immediately. For example, a company automobile might be sold and provide cash of $2,000 or $3,000. Owners and employees can be compensated on an actual mileage basis for use of their personal cars on company business. Or if an automobile is needed on a full-time basis, a lease can be arranged so that a vehicle will be available.

3.5.2 Other Assets

Other assets such as loans made by the business to officers or employees, investments in non-related businesses, or prepaid expenses should be analyzed closely. If they are non-productive, they can often be liquidated so that cash is available to meet the immediate needs of the business.

Any of the above steps can be taken to alleviate short-term cash shortages.

On a long-term basis, the business can minimize its external capital needs by establishing policies and procedures that will reduce the possibility of cash shortages caused by ineffective asset management.

These policies could include the establishment of more rigorous credit standards; systematic review of outstanding receivables, periodic analysis of slow-moving inventories, and establishment of profitability criteria so that fixed asset investments is more closely controlled.

3.6 Cost Reduction

Careful analysis of costs, both before and after the fact, can improve profitability and therefore the amount of earnings available for retention. At the same time, cost control minimizes the need for cash to meet obligations to trade creditors and others.

Before the fact, a business can establish buying controls that require a written purchase order and competitive bids on all purchases above a specified amount. Decisions to hire extra personnel, lease additional space, or incur other additional costs can be reviewed closely before commitments are made.

After the fact, management should review all actual costs carefully. Expenses can be compared with objectives, experience in previous periods, or with other companies in the industry. Whenever apparent excess is identified, the cause of the excess should be closely explored and corrective action taken to prevent its recurrence.

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4 TRADE CREDIT

Trade credit is credit extended by suppliers. Ordinarily, it is the first source of extra capital that the small business owner turns to when the need arises.

4.1 Informal Extensions

Frequently, this is done with no formal planning by the business. Suppliers' invoices are simply allowed to "ride" for another 30 to 60 days. Unfortunately, this can lead to a number of problems. Suppliers may promptly terminate credit and refuse to deliver until the account is settled, thus denying the business access to sorely needed supplies, materials, or inventory.

Or, suppliers might put the business on a C.O.D. basis, requiring that all shipments be fully paid in cash immediately upon receipt. At a time when a business is obviously strapped for cash, this requirement could have the same effect as cutting off deliveries altogether.

4.2 Planning Advantages

A planned program of trade credit extensions can often help the business secure extra capital that it needs without recourse to lenders or equity investors. This is particularly true whenever the capital need is relatively small or short in duration.

A planned approach should involve the following:

- Take full advantage of available payment terms. If no cash discount is offered and payment is due on the 30th day, do not make any payments before the 30th day.
- Whenever possible, negotiate extended payment terms with suppliers. For example, if a supplier's normal payment terms are net 30 days from the receipt of goods, these could be extended to net 30 days from the end of the month. This effectively "buys" an average of 15 extra days.
- If the business feels that it needs a substantial increase in time, say 60 to 90 days, it should advise suppliers of this need. They will often be willing to accept it, provided that the business is faithful in its adherence to payment at the later date.
- Consider the effect of cash discounts and delinquency penalties for late payment. Frequently, the added cost of trade credit may be far more expensive than the cost of alternate financing such as a short-term bank loan.
- Consider the possibility of signing a note for each shipment, promising payment at a specific later date. Such a note, which may or may not be interest bearing, would give the supplier evidence of your intent to pay and increase the supplier's confidence in your business.

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4.3 Ready Availability

Trade credit is often available to businesses on a relatively informal basis without the requirements for application, negotiation, auditing, and legal assistance often necessary with other capital sources.

4.4 Usage

Trade credit must be used judiciously. Its easy availability is particularly welcome in brief periods of limited needs. Used imprudently, however, it can lead to curtailment of relations with key suppliers and jeopardize your ability to locate other, competitive suppliers who are willing to extend credit to your business.

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5 WHAT IS YOUR BORROWING POTENTIAL?

Commercial lending is a heavily regulated industry. You won't be afforded the same luxuries in the decision-making process that you would be in an automotive or home equity loan application. Business plans, financial projections, income tax returns and reams of supporting documentation are often the norm. Why? Well, regardless of any individual bank's willingness to lend, their primary goal is increasing shareholder value.

Consequently, banks tend to be risk-averse and shy away from any ventures that might have a negative impact on the bank's portfolio. Combine that mentality with the discomforting fact those most new small businesses don't survive beyond their third year. This is why commercial borrowing can appear so frustrating. However, it's not all bad news. Banks are in the business of lending money, and good banks want to make good loans. The key is to structure loans that are good for both you and the bank.

The first thing to consider when evaluating your borrowing potential is how much money you really need. This involves determining where your capital is to be used and how it will work for your company. Stay away from guessing. Whenever possible, try to use real numbers.

The Sources and Uses statement can be a helpful tool. As the name implies, a Sources and Uses statement simply ranks individual funding sources and their respective terms and rates. This amount is then matched against the planned allocation of those dollars. The totals of the two categories should be equal. Use the Sources and Uses statement to measure your total capital requirements and determine where that capital will come from.

It's not all bad news. Banks are in the business of lending money, and good banks want to make good loans.

Every business, and every individual for that matter, has a certain level of debt that they can comfortably sustain. This is known as borrowing capacity. Even though there are many considerations that eventually enter into the approval process, there are two measures that can quickly help you determine your company's capacity to borrow. By understanding the nature of sufficient equity and adequate collateral, you can readily refine your loan request into parameters that meet most banks' expectations.

Equity is defined as the contribution advanced by the principles of the business toward the total project costs of any given loan package. Translation: 100 percent debt financing is highly unlikely, if not impossible. Lenders will expect you to absorb a portion of the credit risk. Occasionally, you can incorporate government-lending programs into your loan package to reduce, but not eliminate, the amount of your equity injection. Nevertheless, most credible financing packages will still require some equity investment on your part.

You should plan on injecting a minimum of 20 percent of total project costs into the loan package. Beware, however, that for businesses operating in what are considered high-risk industries, you may be asked to contribute 25 percent, 30 percent or even 40 percent. This is especially true in high-turnover industries such as bars and restaurants. You should also be aware that cash is undoubtedly the best form of equity. Start-up ventures can generally leverage only cash. On the other hand, existing businesses that reflect significant equity on their balance sheet often discover that this equity is not liquid. Their

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discretionary cash has already been spent to purchase equipment or inventory, subsequently reducing their ability to borrow.

Another way of calculating your capacity is by looking at your projected debt-to-worth ratio. This ratio expresses the relationship between capital contributed by creditors and that contributed by owners. The lower the ratio, the greater the proportion of total capital that is invested, not borrowed, by the owners. A high ratio reflects greater financial leverage, which means increased financial risk. Companies with a high degree of leverage may not be able to survive economic downturns as readily as their competitors who are operating with less debt.

5.1 Debt-to-Worth Ratio

To compute your debt-to-worth ratio, divide your projected total liabilities by your tangible net worth. Although banks generally like to see a ratio of 4-to-1 or lower, this figure can vary widely from industry to industry.

Adequate collateral is another necessary ingredient for any good loan package. Bankers want to know how they will get paid if you are not able to make your payments. Collateral addresses this concern. It is security pledged toward the repayment of a loan. If for some reason you don’t pay, the bank can offset its losses by liquidating collateral. Furthermore, not only will the bank want to secure the assets of the business, in many cases they will expect you to pledge your personal assets, as well.

The thing to remember when evaluating collateral is that the value you place on a particular asset is not the same value the bank will place on it. The bank determines the loan value of your assets based on what they could receive for them by selling them in a hurry. Consequently, the inventory that you think is so valuable may only be worth 50 cents on the dollar to your friendly banker.

Specialized, custom-built equipment that you are paying a premium for may be of extreme value to you, but from a liquidation perspective, it is hardly that attractive. Despite the holding power of real estate, it only generates 70 to 80 cents on the dollar, at best.

5.1.1 Collateral

Before you approach a potential funding source, calculate what you can provide in the way of collateral. Figure 60 percent to 80 percent of your appraised real estate holdings, less any mortgages or liens. Look at your company’s equipment, and consider its resell value. Factor in obsolescence, the condition of the equipment, even the degree of specialization.

How much is it really worth on the open market? When considering inventory, look at how marketable the product is. Is it seasonal or perishable? Is it a consumer good that may be readily exchanged, or does it have value only to a specialized industry with few buyers? Examine the quality of your account receivables? Look at the “aging” of your receivables. Do you have any more than 90 days? Do you have any un-collectable accounts? Those will not qualify as adequate collateral. Better to allow 65 to 85 cents on the dollar for only those receivables less than 60 days.

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Collateral can also come from sources other than your own assets. Assets such as real estate, stocks and bonds, or CDS pledged by co-signers frequently serve as adequate collateral. On occasion, some banks will use signed contracts and purchase orders as collateral. Moreover, many government-lending programs maintain that a lack of collateral is specifically not a deterrent to obtaining a government loan guarantee.

Knowing that you have sufficient equity and adequate collateral can greatly increase the probability of obtaining commercial financing. However, it does not guarantee that the loan will be approved. All businesses should be prepared to provide additional supporting documentation to their lender. They should also be keenly aware of the impact new debt has on their cash flow

6 DEBT CAPITAL

Debt capital is an amount of money borrowed from a creditor. A note, signed by the borrower, agreeing to repay the principal amount borrowed plus interest on some predetermined basis, usually evidences the amount borrowed.

The terms under which this money is borrowed may vary widely. Short-term notes can be issued for periods as brief as 10 days to fill an immediate need. Long-term notes can be issued for a period of several years.

When the terms of this debt are negotiated, a payment schedule is established for both interest obligations and principal repayment.

6.1 Discounted Notes

In some cases, particularly in short-term borrowing, the total amount of interest due over the term of the note is deducted from the principal before the proceeds are issued to the borrower. Such a note is called a discounted note.

Short-term borrowing usually requires repayment within 60 to 90 days. Notes are often renewed, in whole or in part, on the due date; provided that the borrower has lived up to the obligations of the original agreement and the business continue to be a favorable lending risk.

Commercial banks are the ordinary source of short-term loans for small businesses.

6.2 Credit Lines

When a business has established itself as being worthy of short-term credit, and the amount needed fluctuates from time to time, banks will often establish a line of credit with the business. The line of credit is the maximum amount that the business can borrow at any one time. The exact amount borrowed can vary according to the needs of the business but cannot exceed its established credit line.

These arrangements give the business access to its requirements up to the credit limit, or line. However, it pays interest only on the actual amount borrowed not the entire line of credit available to it.

6.3 Long-term Debt

Long-term debt is borrowing for a period greater than one year. This general classification includes “intermediate debt” which is borrowing for periods of one to 10 years.

For small businesses, borrowed capital for periods greater than 10 years is usually available only on real estate mortgages. Other long-term borrowing usually falls into the “intermediate” classification and is available for periods up to 10 years. Such loans are called “term loans.”

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6.4 Mortgage Payment Schedules

Principal and interest payments on mortgages usually involve uniform monthly payments that include both principal and interest. Each successive monthly payment reduces the amount of principal outstanding.

Therefore, the amount of interest owed decreases and the portion of the monthly payment applicable to principal increases. In the early years of a mortgage, the portion of the monthly payment applied against the principal is relatively small, but grows with each payment.

6.5 Term Loan Payment Schedules

For term loans, payment of principal and interest is ordinarily scheduled on an annual, semiannual, or quarterly basis. For example, a 5-year, $50,000 term note bearing 10% interest might have the following payment schedule specified in the note agreement:

END OF PRINCIPLE YEAR	PRINCIPLE REPAYMENT	PRINCIPLE OUTSTANDING	INTEREST PAYMENT 10%
1	$10,000	$50,000	$5,000
2	$10,000	$40,000	$4,000
3	$10,000	$30,000	$3,000
4	$10,000	$20,000	$2,000
5	$10,000	$10,000	$1,000

6.6 Repayment Schedules

The dates on which principal and interest payments are due should be scheduled carefully. For example, a manufacturer with heavy sales just before Christmas and receivables collections through January might best be able to schedule repayments in February. If a payment were due in October or November, when inventories were high and receivables were climbing, the payment could be crippling.

6.7 Collateral

Loans may be secured or unsecured. In a secured loan, the borrower pledges certain assets as collateral (security) to protect the lender in case of default on the loan or failure of the business. If the business defaults on the loan through failure to meet interest obligations or principal repayments, the note-holder (lender) assumes ownership of the

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collateral. If the business fails, the note-holder claims ownership of those specific assets pledged as collateral before the claims of other creditors are settled.

6.7.1 Typical Collateral

In long-term borrowing, fixed assets such as real estate or equipment are usually pledged as collateral.

For short-term borrowing, inventories or accounts receivable are the usual collateral.

6.8 Inventory Financing

Inventory financing is most commonly used in automobile and appliance retailing. As the retailer purchases each unit, the lender pays the manufacturer. The retailer repays the lender when the unit is sold. Interest is determined separately for each unit, based upon the actual amount originally paid by the lender and the period between the time the money is paid and the lender is reimbursed by the retailer.

6.9 Accounts Receivable Financing

Basically, accounts receivable financing falls into two categories as follows:

- Assignments. The business pledges, or “assigns,” its receivables as collateral for a loan.
- Factoring. The borrower sells its account receivable to a lender (“factor”).

Although these arrangements are not loans, in a pure sense, the effect is the same.

6.9.1 Receivables Assignments

When receivables are assigned, the amount of the loan varies according to the volume of receivables outstanding. Normally, the lender will advance some specified percentage of the outstanding account receivable up to a specific credit limit. For example, look at the schedule below. The company can borrow up to 80% of assigned receivables, up to a maximum of $100,000.

ACCOUNTS RECEIVABLE	AMOUNT BORROWED
$100,000	$80,000
$125,000	$100,000
$150,000	$100,000

1. On the first line, accounts receivable is $100,000 and the amount loaned is 80% of $100,000, or $80,000.
2. On the second line, outstanding receivables are $125,000. The amount loaned increases to $100,000 ($125,000 x 0.80).

3. On the third line, accounts receivable is $150,000. Eighty percent of this amount would be $120,000. However, this exceeds the established limit of $100,000. Therefore, borrowing is restricted to the $100,000 limit.

In many industries, accounts receivable financing is considered a sign of weakness. However, it is quite common in others. This is particularly true in the garment industry and in personal finance companies.

When customers must pay invoices directly to a factor, it may create doubts about the company's financial stability and, therefore, its ability to deliver.

When accounts receivable are assigned, the borrower is still responsible for collection. Upon collection of any receivable, the amount borrowed should be repaid. Interest is based upon the amount borrowed and the time between receipt of proceeds by the borrower and repayment.

6.9.2 Factoring Accounts Receivable

When accounts receivable is factored, they are sold to the factor and the borrower has no responsibility for collection. The borrower pays the factor a service charge based upon the amount of each receivable sold. In addition, the borrower pays interest for the period between the sale of the receivable and the date the customer pays the factor.

Since the factor is responsible for collection, it will only purchase those receivables for which it has approved credit.

6.10 Unsecured Debt

The secured creditor's risk is reduced by the claim against specific assets of the business. In default or liquidation, the secured creditor can take possession of these assets to recover any unpaid amounts due from the business.

Holders of unsecured notes do not enjoy the same protection. If the company defaults on a payment, the unsecured creditor, under normal circumstances, can only renegotiate the amount due, perhaps by seeking collateral, or force the company to liquidate. In liquidation, the holder of an unsecured note would normally have no rights that are superior to those of any other creditors.

6.11 Restriction on Business

Therefore, when accepting an unsecured note, the lender will often place certain restrictions on the business. A typical restriction might be to prevent the company from incurring any debt with a prior claim on the assets of the business in the event of default or failure.

For example, a term note agreement might prevent a company from financing its receivables or inventories since this would result in a prior claim against the assets of the business in liquidation.

Such restrictions may have no effect on the business' ability to operate. However, in other cases, such restrictions could be severe. For example, a business may have a chance to

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sell to a major new customer. The new customer may insist upon 60-day credit terms, which will require the business to seek additional external financing.

Normally, this financing might be readily available on realistic terms from a factor. However, the restriction of the unsecured note could prevent the business from taking advantage of this significant opportunity for sales and profit improvement.

6.12 Personal Guarantees

The liability of a corporation's shareholders is generally limited to the assets of the business. Creditors have no normal claim against the personal assets of the stockholders if the business should fail. Therefore, many lenders, when issuing credit to small corporations, seek the added protection of a personal guarantee by the owner (or owners). This protects the creditors if the business fails, since they retain a claim against the personal assets of the owners to fulfill the debt obligation.

6.13 Interest Rates

The interest rates at which small businesses borrow are relatively high. Banks and other commercial lending institutions normally reserve their lowest available interest rate, the so-called prime rate, for those low-risk situations such as short-term loans for major corporations and public agencies. Here, the chances of default are slim and the costs for collection credit search, and other administrative tasks are minimal.

Because of the higher risks involved in loaning to small businesses, lenders often seek greater collateral while charging higher interest rates to offset their added costs of credit search and loan administration.

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7 EQUITY CAPITAL

Unlike debt capital, equity capital is permanently invested in the business. The business has no legal obligation for repayment of the amount invested or for payment of interest for the use of the funds.

7.1 Share of Ownership

The equity investor shares in the ownership of the business and is entitled to participate in any distribution of earnings through dividends, in the case of corporations, or drawings, in the case of partnerships.

The extent of the equity investor's participation in the distribution of earnings of a corporation depends upon the number of shares held. In a partnership, the equity investor's participation will depend upon the ownership percentage specified in the partnership agreement.

The equity investor's ownership interest also carries the right to participate in certain decisions affecting the business.

7.2 Legal Liability

The personal liability of equity investors for debts of the business depends upon the legal form of the organization. Basically, the investor who acquires equity in a partnership could be personally liable for debts of the business if the business should fail. In a corporation, the liability of equity investors (shareholders) is limited to the amount of their investment.

In other words, if a partnership should fail, creditors could have a claim against the personal assets of the individual partners. If a corporation should fail, the only claims of creditors would be against any remaining assets of the corporation, not against any personal assets of the shareholders.

7.3 Equity Investor's Compensation

The purchaser of an equity interest in a business expects to be compensated for the investment in any of the three following ways:

- Income from earnings distribution of the business, either as dividends paid to corporate shareholders or as drawings in a partnership.
- Capital gain realized upon sale of the business.
- Capital gain realized from selling his or her interest to other partners.

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7.4 Capital Gains

Capital gain is the term used to describe any excess of the selling price of an investment over the initial purchase price. For example, if you purchased an equity interest in a business for $5,000 and later sold it for $8,000, you would realize a capital gain of $3,000 ($8,000 - $5,000).

7.4.1 Tax Advantages

Long-term capital gains are those realized on investments held for a period longer than six months. These gains are subject to federal income tax at an effective rate equal to one-half of the investor's tax rate on ordinary income. Therefore, income tax advantages are often a major cause of the investor's desire to acquire an equity interest.

7.5 Earnings Distribution

The equity investor in a partnership is entitled to a share of all drawings paid out to partners at a percentage established when the interest was purchased. For example, assume an investor acquired a 20% interest in a partnership. The distribution of earnings to all partners in a given year is $20,000. The holder of the 20% interest would receive $4,000 ($20,000 x 0.20).

The dividends received by the equity investor in a corporation depend upon the number of shares held. For example, if a corporation voted a dividend of $1.50 per share in a given year, the owner of 1,000 shares would receive a dividend of $1,500 (1,000 x $1.50).

7.6 Sale (or Liquidation) of Business

If a business is sold or liquidated, the equity investor shares in the distribution of the proceeds. As with an earnings distribution, the share of the proceeds in a corporation sale depends upon the number of shares held. In a partnership, each partner's share of the proceeds is based upon the percentages specified in the partnership agreement.

If the proceeds received by the equity investor exceed the original purchase price, this excess is considered a capital gain and taxed accordingly at effective rates more favorable than those for ordinary income.

If the business were liquidated, the assets would be sold and the proceeds would first be used to discharge any outstanding obligations to creditors. The balance of the proceeds, after these obligations had been fulfilled, would be distributed to the equity investors in accordance with their shareholdings or percentages of interest.

7.7 Sale of Equity Interest

As a business prospers and grows, the value of an equity interest grows with it. Therefore, the equity investor may be able to sell his or her interest at a price higher than the initial acquisition cost.

For example, an equity investor in a corporation may have purchased his or her interest at $10.00 per share. As the business grows, he or she is able to sell the shares at $15.00 per share, realizing a capital gain of $5.00 ($15.00 - $10.00) on each share sold.

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7.8 Capital Gains vs. Dividends

In many cases, the equity investor in a small business is primarily interested in capital gains. Aside from the tax advantages described earlier, the equity investor usually realizes that the earnings of the small business are better retained in the business than distributed as dividends or drawings.

Retention of earnings permits the business to grow so that the value of the equity interest increases. The investor can realize a return on the investment through a capital gain derived from selling his or her shares or upon sale of the business.

7.9 Public Stock Offerings

When businesses are first organized, equity capital is usually secured from a combination of sources such as the original owners' personal savings and through solicitations from friends, relatives, or other persons known to have financial capability for such investments.

As the need for equity capital becomes greater, say $50,000 to $200,000, it is customary to seek capital through the services of professional finders, who receive a fee for securing the capital needed. These finders normally have access to wealthy individuals, capital management companies, estates, trusts, and others with sufficient capital to make such an investment.

At higher levels of capital need, shares are sold through public offerings. The public offering seeks to attract a large number of investors to purchase stock, in large or small amounts. A market is then created for the stock. Shares purchased by the public, as well as the shares held by the original owners, and any subsequent equity investors can also be sold at the going market price. These transactions do not have a direct effect on the business' capital position since it does not receive the proceeds from the sale.

The equity investor can realize a capital gain by selling shares at prices higher than the original purchase price.

7.10 Risks of Equity Investment

The equity investor assumes substantial risk. Unlike the secured creditor, the equity investor has no specific claim against any assets of the business. In liquidation, all claims of all creditors must be satisfied before any remaining assets become available for distribution to the owners. Even then, the equity investor's participation in the proceeds is restricted to a share that is proportionate to the number of shares held or the partnership interest.

Since the risks of equity investment are so substantial, particularly in the case of small businesses, equity investors expect a considerably higher return than the lender.

A lender might be willing to loan money to a business at an interest rate of 10% or 12% since it has certain legal protections in the event of default or liquidation. The investor of equity capital in the same business might seek a far higher return, perhaps 20%, 50%, or even more in order to compensate for the added risk of equity investment.

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8 SOURCES OF CAPITAL

This section covers the various sources of capital that are available to the small business owner. The need for additional capital occurs frequently in many small businesses. The ability of the owners to anticipate the need and to know the various money sources available to them will help them secure needed capital on favorable terms.

8.1 Internal Sources

Those businesses that are alert to opportunities for internal capital generation will often find that this effort not only minimizes the need for external capital, but also opens the doors of the outside money market to them.

This report has explored both internal and external capital sources, showing you how you can minimize your need for external financing through proper asset management and retention of earnings.

8.2 External Sources

You have seen how the availability of trade credit can be utilized intelligently in order to maintain favorable supplier relations while taking full advantage of the credit that is available to you from this vital and convenient source.

Various types of loan arrangements were also explored, considering both short- and long-term needs as well as typical requirements for security through pledging of specific assets or the owners' personal guarantees. Finally, the equity capital market described earlier outlined what the equity investor expects in return for a commitment of capital and the effect that the equity investor's interest can have on your business.

8.3 Certainty of repayment

Repayment ability rests on two basic facts. Are you willing and able to repay? The best evidence of willingness to repay is a good personal and business credit record. Order personal and business credit reports before you approach the bank. You will likely be shocked at the amount of stale or erroneous information.

Get a copy of your consumer's rights from the credit bureau (such as, Equifax) and clean out any errors in your report. If there are some accurate "black marks," you may include your side of the story, up to 100 words, in the credit file. Also, you should provide an explanation in your loan package narrative.

Your business' ability to repay is judged on both its historical and its projected earning power. Include your last three years' personal and business income tax returns in the loan package. Bankers assume that you are not likely to overstate your Income to the Government. Also, include the last three years' company or accountant-prepared balance sheets and income statements. Explain any meaningful differences between the tax and

the company-prepared statements. Complete an interim income statement and balance sheet if you are more than 30 days past your year-end.

8.3.1 Cash Flow Projection

Prepare a cash flow projection, by month, for the next 12 months if you are asking for seasonal financing. Extend the cash projection out another two years by month if you are after a long-term loan. Build the repayment of the loan into the projection. You must justify all the business operating assumptions underlying the cash projection.

"Now wait!" you say, "Give me a break. I'm a small business. Surely the bank understands and will cut me some slack from all this paperwork." Wrong! These are minimal expectations for any well-managed business. Do you want slack or do you want the loan? Besides, you would be surprised, all too few business owners come this well prepared.

Get the bank's personal financial statement form before you even talk to a banker about your loan. Then fill it in carefully, neatly, and in great detail as part of your loan package. Review the statement with your accountant for accuracy. Overstated assets or understated liabilities are presumed lies, not mistakes. Banks don't knowingly lend to liars.

Most personal financial statements look as if they were completed in the car on the way to the bank. They don't add up correctly. Entries made on the wrong line. Supporting schedules left incomplete. You want to be different. The loan process slows down every time you make the banker ask you a question because you failed to supply complete information.

I am a great believer in business plans as part of a loan package. But in reality too few businesses have one. And if they do plans just for the loan proposal, it usually isn't very good. Even if you don't have a business plan, some plan elements must be in the loan package. Include a thorough functional (as compared to historical) resume. Business management ability is a constant theme running through the loan approval process.

The loan officer doesn't care what you did in the past, if it has no bearing on what it takes to succeed in your business today. Don't make them wade through your job history that describes positions held rather than skills learned, time spent instead of experience gained, and assigned responsibilities rather than tasks completed. Instead use a functional resume to highlight those acquired skills, abilities, experiences, and knowledge essential to running your business today and tomorrow. **Demonstrate why you will succeed and prosper.**

Since you cannot do it all alone, the bank also wants to know about the rest of your team - even if it is only two or three key employees. Also, identify your accountant, business consultant, your attorney, and insurance agents in your proposal. No business is too small to be professional and businesslike.

8.4 Adequate collateral

Banks want collateral. Unsecured loans to small business are rare. The bank is lending you its depositors' money and it wants it back. Collateral is to repay the loan if all else falls. It's that simple. The bank wants the loan value of your assets pledged as collateral to equal the amount of the loan.

You will not find the definition of "loan value" in any accounting or economics textbook. It is not what you paid for your assets. It is not what you show they are worth on your balance sheet. It is not what it would cost you to replace them. Loan value is what the bank can get for your collateral after they take it away from you and sell it in a hurry. It is a liquidation value.

The bank liquidates collateral at auction or through dealers or through sale to your customers, your competitors or your suppliers. None of these buyers will ever pay top dollar! They lick their chops when they see the bank coming.

At the time the loan is made, the bank makes an informed guess as to the future liquidation value of the collateral. Bankers guess higher if you are in a healthy industry and if there is an active resale market for your type of asset. They guess higher if it is not specialized collateral, if the assets hold their value over time, or if they are easily liquidated.

The best collateral is the banks own certificate of deposit. The worst is a custom-designed specialty sausage-making machine, bolted to a concrete slab in a refrigerated, sterile manufacturing room.

Loan value is really a judgment call. It is a very easy call with a car. Just look it up in the dealer guide. Publicly traded financial securities and cash surrender value of life insurance are easy to value. After that it becomes more difficult. An appraisal is simply an informed guess. It is your job to influence the bank's judgment.

Show the banker "indirectly" how to liquidate your collateral (not that such a thing would ever be necessary!). Discuss secondary or resale markets, provide a list of dealers, show current prices for new and used equipment, include pictures of the assets, maintenance records, and so on. Only you can help the banker with this very industry-specific information. Only you know what helps assets in your industry retain their value.

Bankers hardly bother guessing loan collateral value at all, if they can get the Federal Government in Canada or Small Business Administration in the U.S.A., to insure the loan.

One of our clients, observing his ¾ inch-thick proposal for a $100,000 line, said, "With this package it's a no-brainer' for the bank." He understood the game! Do all loan applicants have to go that far? Not really, but most should.

Bankers have job performance standards they must meet to earn raises and promotions. The loan officer is squeezed between increasing the size total loan portfolio under their supervision and minimizing loan losses from that same portfolio. Loan officers try to avoid small loans that require large amounts of investigative and analytical work or, as bank call it, "due diligence." Too much work for too few dollars is the poison ivy of the banking industry.

Make the banker's due diligence easy! Prepare a well-organized loan proposal. Explain your business, its risks and opportunities. Analyze your competitive strengths, but don't knock the competition. Explain the industry and economic conditions that you cannot control, but to which you must respond. Include trade association industry analyses or forecasts. Use pictures, promotional materials, special internal management reports, and customer testimonials.

Describe your physical assets by type, manufacturer, serial number, date of purchase, book value, estimated market value or current appraisal or tax valuation. After he has had a chance to look at your proposal, get the banker out to your place of business for a tour.

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A borrower will always have to answer seven questions:

1. How much money do you need? Answer with an exact amount. You can include a justified allowance for contingencies in your loan request.
2. How will you use it? Give great detail. Include construction estimates, vendor price quotes, budgets, etc.
3. Why do you need the bank's money? Show you have a down payment. Prove you have not squandered past business profits.
4. How will you repay the loan? Your cash flow projection will show repayment from excess cash flow from profitable operations, or asset liquidation or new equity or another loan.
5. When will you pay it back? Again answered in the cash flow projection.
6. What happens if something goes wrong? The answer is the loan value of the collateral and the strength of your personal guarantees.
7. Why is this loan good for your business? Explain how the loan proceeds reduce costs or increase revenues or add efficiencies, etc. Banks want to make productive loans that increase employment and create profits.

These questions are first in the banker's mind. Try to weave the answers into the first five minutes of your discussion with the banker. Watch them pay attention and start to treat you seriously.

In the last few years, the consolidation of the banking industry and the need for greater efficiency have led many banks to centralized credit decision making. This means the loan officer across the desk from you has virtually no authority to say "Yes." He must "sell your loan upstairs" to a decision-maker you will never meet. Your task then is to make the loan officer into an enthusiastic advocate - a champion - for your loan. You can do it only with information.

Are you doing the banker's job? Certainly, for the small loan, if you don't do the work, neither will the banker. You may find this a discouraging and daunting task. In the past it often was too easy to borrow money. Now it seems too hard. The act of preparing a complete loan presentation will greatly benefit your business.

Finally, maybe the answer is not a bank loan at all. The last seven years have seen a substantial growth in alternatives to bank financing. Small dollar leasing companies are not as stringent as banks. Commercial factors are more interested in your customers' credit strength than in yours. Many community-based micro loan programs (loans under $20,000) are more forgiving of poor credit and less demanding of collateral.

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9 POTENTIAL FUNDING PROBLEMS

Banks reject small business loan applications most often because of:

- Inadequate collateral,
- The newness of the business, or
- Lack of relationship between the owner and the bank.

Getting credit for a business can be a dilemma because until you've developed a good track record with business credit, many commercial banks and other traditional lenders will be reluctant to extend credit to you.

In order 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.

9.1 Stages of a Developing Business

- Stage one businesses are start-ups.
- 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.

Lenders suggest that rather than approaching a bank, owners of businesses in stages one and two should seek financing from informal investors. Such sources of funding may include friends or relatives, partners, local development corporations, state and local governments offering low-interest micro loans, private foundations offering program-related investments, credit unions featuring small business lending, and universities with targeted research and development funds.

Lenders say those businesses in stage four, and some in stage three, are sufficiently developed to approach a commercial bank or another traditional lender for a loan.

If your business is in stage three or four and you intend to approach a commercial bank, lenders suggest that you first submit an application to a bank with which you have an established relationship. If you do not have an established relationship with a bank, lenders recommend that you ask an experienced accountant or lawyer to contact a bank and present your proposal.

Also, keep in mind that you must choose a legal designation—sole proprietorship, partnership, or corporation—and execute the necessary documentation for your small business before approaching a bank or another lender.

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9.1.1 Reason to Borrow

There are three major reasons why businesses borrow; the first and most common reason is to purchase assets. A loan to acquire assets could be for buying short-term, or current, assets—such as inventory—and would be repaid once the new inventory is converted into cash as it is sold to customers.

Alternatively, the funds could be for the addition of long-term, or fixed, assets, such as equipment. The second reason is to replace other types of credit. For example, if your business is already up and running, it may be time to take out a bank loan to repay the money you borrowed from a relative.

Alternatively, you may wish to use the funds to pay suppliers more promptly to get a discount on the price of the merchandise. The third reason is to replace equity. If you wish to buy a partner's share in your business but you don't have the cash to do it, you may consider borrowing.

9.1.2 Loan Types

The purpose of your loan is critical in determining the type of loan you 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. There are a number of loan types available to commercial borrowers, including lines of credit, seasonal commercial loans, installment loans, collateral based loans (which are secured with assets), credit card advances, and term loans. Regardless of the type, most loans have the following features.

9.1.3 Common Loan Features

- Loans are long term or short term.
- Interest rates vary depending on the term, type, size and risk of the loan.
- Repayment may be a lump sum or on a monthly or quarterly schedule.
- Payments may be delayed until the funds help your business generate cash flow.
- The loan may be committed, meaning the bank agrees to lend to you under certain terms, as you need funds without requiring you to re-apply each time.
- Some loans require that you maintain compensating balance levels in a deposit account.

9.1.4 Loan Agreements

You also should be aware that the lender would expect you to agree to certain performance standards and restrictions in order to ensure that your business can repay the loan. These restrictions, known as covenants, representations, and warranties, commonly include the following. Common Loan Restrictions Maintenance of accurate records and financial statements

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- Restrictions on dividends or other payments to owners and/or investors
- Restrictions on additional capital expenditures
- Restrictions on sale of fixed assets
- Performance standards on financial ratios
- Current tax and insurance payments

9.2 The First Step: Preparing Your Business Plan and Loan Request

When you apply for a business loan, you will need to provide certain information about yourself and your business in the form of a business plan. A business plan can act as ongoing management guides to help you establish production goals and measure actual performance. Your business plan can help demonstrate to a prospective lender that you have the knowledge, managerial competence, and technical capability to run a successful business.

The plan must be thorough and well organized. The finished document should be typed and placed in a binder. Make several copies for each of your prospective lenders and keep several copies for your files. Lenders recommend that you prepare the plan with the help of a professional.

9.3 The Business Plan

The business plan should include the following sections[1]**:**

- Title page. List the name of the business, the owner(s), the address, and telephone and fax numbers.
- **Executive summary**. Provide a brief summary of the plan and tell the reader how it is organized. The executive summary should be written last because it will draw on the other parts of the business plan. It tells who you are, the function of the company, and gives a summary of your purpose for borrowing.
- **Company description**. Give an overview of the function and history of your company, its size, products or services, and markets.
- **Market analysis**. Present your research and a discussion of the conditions and trends within the industry. Review the market for your product and the demand for it. Describe how many major competitors you have, how much of the market each of your competitors controls, and your strategy for gaining a share of the market or developing a new niche. You should be able to explain any barriers to entry into new markets you are considering and how you plan to overcome them.
- **Products and services**. Explain your product or service and its function.

[1] See **Report 1 "Internet Business Basics"**, Published by **Global Millennia Marketing** in **the "Internet Business Planning and Funding"** series.

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- **Operations**. Explain how you make your product or provide your service. Specify how you get your product out the door to the customer. Where will you get your raw materials or inventory? If a manufacturing process is involved, describe it here, including the size of the factory, stages of production, and work flow. Or, if you have a retail business, give the location of your store. How was the site selected? Where will inventory be warehoused?
- **Marketing plan**. Describe how you intend to sell your product or service and who will buy it. Also, discuss your distribution plans, advertising arrangements, and sales force.
- **Ownership**. Indicate what type of legal entity your company is and its ownership structure: sole proprietorship, partnership, or corporation. If you have partners, who are they? How much of your company do they own? Describe how these individuals became principals and what you have agreed to give them in return for their investments.
- **Management and personnel**. Review who is in charge, who works for you, and why you hired them. Describe how their experience will contribute to the success of your business. Include resumes of essential people, including yourself.

In this section, you will need to demonstrate your understanding of basic accounting and the financial concepts that are crucial to the success of your business. By using complete and correct financial statements, you will be able to communicate to a prospective lender how these concepts are successfully applied in your business.

- **Funds required and expected use**. Summarize why you need a loan and how you will use the money. Ask for a specific amount. Include documentation on collateral, guarantor agreements, and signed contracts. Describe your repayment plan and present a contingency plan should your initial source of repayment fail.
- **Financial statements and projections**. Include a personal financial statement, personal tax returns, and business financial statements—balance sheet, profit and loss statement, cash flow analysis for the last three to five years (if you have been in business that long), and projections for the expected performance of your business for the upcoming three-year period.
- **Appendices/exhibits**. This section should document any issues that cannot be addressed in the text. For example, distribution agreements, contracts for the purchase of your product, and your operating licenses would all be included as appendices.

9.4 What the Lender Will Review

9.4.1 Credit Analysis

Regardless of where you seek funding—from a bank, a local development corporation, or a relative—a prospective lender will review your creditworthiness. A complete and thoroughly documented loan request (including a business plan) will help the lender

understand you and your business. The basic components of credit analysis, the "Five C's," are described below to help you understand what the lender will look for.

9.4.1.1 The "Five C's" of Credit Analysis

- **Capacity** to repay is the most critical of the five factors. The prospective lender will want to know exactly how you intend to repay the loan. The lender will consider the cash flow from the business, the timing of the repayment, and the probability of successful repayment of the loan. Payment history on existing credit relationships—personal or commercial—is considered an indicator of future payment performance. Prospective lenders also will want to know about your contingent sources of repayment.
- **Capital** is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Prospective lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding.
- **Collateral** or guarantees are additional forms of security you can provide the lender. Giving a lender collateral means that you pledge an asset you own, such as your home, to the lender with the agreement that it will be the repayment source in case you can't repay the loan. A guarantee, on the other hand, is just that—someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan.
- **Conditions** focus on the intended purpose of the loan. Will the money be used for working capital, additional equipment, or inventory? The lender also will consider the local economic climate and conditions both within your industry and in other industries that could affect your business.
- **Character** is the general impression you make on the potential lender or investor. The lender will form a subjective opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background and experience in business and in your industry will be reviewed. The quality of your references and the background and experience levels of your employees also will be taken into consideration.

9.5 Financial Analysis

In addition to the "**Five C's**," a prospective lender will use four primary financial statements to make a credit decision.

9.5.1 A Personal Financial Statement

Indicates your net worth. Each partner or stockholder owning a substantial percentage (for example, 20 percent or more) of the business should submit one. A personal financial

statement is important to the lender, particularly if you have never received financing for your business before, because it gives the lender evidence of personal assets you could pledge to secure a loan.

9.5.2 A Balance Sheet

Provides you with a snapshot of your business at a specific time, such as the end of the year. It keeps track of your company's assets, or what the company owns (including its cash), and the company's debts, or liabilities (generally loans from others). It also shows the capital, or equity, put into the business.

9.5.3 A Profit and Loss Statement

Shows the profit or loss for the year. The profit and loss statement, also called the income statement, takes the sales for the business, subtracts the costs of goods sold, then subtracts other expenses.

9.5.4 A Statement of Cash Flows

Presents the sources of cash in your business—from net income, new capital, or loan proceeds—versus the expenditures, or uses of the cash, over a specified period of time. An example of the cash flow statement for F.E.D. Foods Company is shown below.

It's at this stage that you will appreciate having an effective accounting system. Without this system, you won't know if you are profitable or not, let alone if you are liquid enough (simply put, have enough cash on hand) to pay for the next order of merchandise. A good system also will help you track your company's growth and anticipate future cash needs.

9.6 Ratio Analysis

Another tool the lender will use is financial ratio analysis. Ratios permit review of a company's current financial performance versus that of previous years. In the same way that a medical checkup tests one's heart, lungs, and changeable factors such as body weight, an analysis of a company's financial performance considers the status, changes, and relationships of critical components of a company's health.

The lender also may use financial ratio analysis to consider how a company is doing when compared to another company. A limitation of such comparative analysis is that different industries are driven by different factors. As a result, the financial ratios of a manufacturer and retailer can be quite different even though both companies may be similarly successful.

Lenders are trained to appreciate both the benefits and limitations of ratio analysis and to consider financial results in the context of the company's "peer group" of similar companies within its industry. To find out what the benchmarks are for your type of business, you may refer to guides published by Robert Morris Associates and others.

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9.6.1 Profitability

Profit is the compensation an entrepreneur receives for the assumption of risk in a business venture. The profitable business must cover its overhead expenses and generate profits for its owner out of its “after-product-costs” cash.

9.7 Pro Forma Financial Statements and Financial Projections

Pro forma financial statements are the entrepreneur’s best guess about what next year will look like for the business. These tools will help you anticipate whether next year’s cash flow will be sufficient to cover all your costs, and if not, how much money you will need to borrow.

For a longer horizon, financial projections permit you to make estimates about future sales levels, expansion costs, or general businesses conditions and see how such conditions would affect your company’s financial results in the years to come.

The preparation of pro-formas and projections is a complex exercise that requires a sound knowledge of financial accounting. However, with the help of your accountant or the advice of a business consultant, the exercise can provide both you and your potential lenders with valuable insights into your business.

9.8 Resources and How to Use Them

There are numerous programs available to assist prospective and existing small business owners. Many are wholly or partially funded by federal or local government entities and can provide services to you at low or no cost. Sometimes staffed by university professors and graduate business students, retired business executives, or small business consulting specialists, these programs are excellent sources of advice.

Small business assistance programs generally fall into two categories: training programs, which teach business owners technical and financial skills, and loan programs, which offer loans or loan guarantees for small businesses.

9.8.1 Training Programs

Depending on the organization and on your particular needs, training programs offer skill—building assistance either in the classroom for several weeks or in individual counseling sessions.

- Technical assistance programs can cover a wide range of topics and their applicability depends on the nature of your business. Topics may include production, marketing, distribution, packaging, import/export documentation, and human resources or staff management.
- Financial skills assistance programs may include basic accounting, cash flow management, sales projections, feasibility studies, and tax planning.
- Business plan development courses include components of both the technical and financial programs and assist you with composing, preparing, and presenting your business plan and loan proposal to prospective lenders.

9.8.2 Loan Programs

Loan programs are among the resources offered by small business investment corporations and state or local development corporations. These programs typically have funds available to lend directly to new or expanding businesses. They also may offer guarantees or other support for a loan given by a traditional lender, such as a bank, to help mitigate the bank's risk of lending directly to a new small business.

One advantage of approaching an organization with a loan program rather than a bank is that the organization may have funds dedicated solely to the new small business market. It also may be receiving some type of government subsidy that permits it to offer lower interest rates for small business loans. Programs that provide guarantees from a government agency to pay the loan if your business fails may convince a bank to lend to your business when it otherwise wouldn't.

9.8.3 Government Programs

In Canada, the Federal Office of Regional Development in each province have a number of Small Business Access Centres. As well, the Federal Business Development of Canada has a guaranteed small business loans program.

Created in 1953, (USA), the Small Business Administration (SBA) provides management and financial assistance to small businesses. Mainly, the SBA guarantees loans through financial institutions. The loans may be used for working capital, machinery and equipment, acquisition of real estate, and expansion.

9.9 If Your Application Is Not Approved

If your loan is not approved, ask why. You are entitled by law to a written statement of the reasons for a loan denial, if you request it. Many banks automatically supply the reasons for denial in writing.

Knowing the reasons for a loan denial can inform you of areas in your proposal that did not meet the lender's standards. Since all lenders do not share identical standards, another lender may reach a different credit decision.

Review your loan proposal in light of the lender's comments. See how you can use the resources or ideas presented in this booklet to strengthen your application. Go through the process of reviewing your technical and financial material again, and then review your business plan. Find any areas that could be augmented further and lead to an approval on your next request.

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10 LOAN PROPOSAL

10.1 Description of business

1. Industry/type of business
2. Markets & customer description
3. Competitive position
4. Form of Business Organization
5. Federal/State employer ID numbers
6. Principal's Name & Address
7. Other owners
8. Other locations
9. Years in Business
10. Years under current management

10.2 Amount requested

1. Purpose(s) of loan (and business goals to be achieved)
2. Uses of funds (land, building, equipment, inventory, working capital, etc.)
3. Sources of repayment and security

10.2.1 Supporting Documents

1. List of equipment/furnishings to be purchased
2. Bids/quotes as appropriate (source of loan amount estimates)
3. Collateral listing
4. Business Plan
5. Last 3 year's financial statements: balance sheet, income statement
6. Projected financial statements: Cash Flow (Monthly, year 1)
7. Income Statement (annual, years 1-3)• Balance Sheet (annual, years 1-3)
8. Income Tax returns
9. Resumes of key managers
10. References: Credit/Business/Personal

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11 ABOUT GLOBAL MILLENNIA MARKETING

Global Millennia Marketing Inc. is one of the first of a new breed of integrated Internet marketing communications companies and is comprised of four on-line divisions. Our ability to work closely at all levels optimizes synergy between the different divisions from the strategic planning stage right through to tactical execution of all our projects.

John Shenton B.Eng., President of Global Millennia Marketing, is a dynamic, adaptable and results driven Senior Executive with many years experience in building and operating companies in N. America & Europe, creating market presence and increasing sales throughout domestic and International markets worldwide.

His strong technical and analytical background is supported by comprehensive sales, marketing, operational, and general management skills in the computer, Internet and telecommunication industry.

He has a great deal of International experience, having lived and worked within the United Kingdom, Germany, Switzerland and Canada.

As the use of New Digital Media such as the Internet, CD-ROM's, DVD's, increases, the importance of coordinating its use with traditional printed media becomes paramount. We are uniquely placed to address this need, having evolved from genuine specialists in both fields.

We work with our clients to develop effective, long-term partnerships, which encompass every facet of the management and marketing functions, from initial project consulting through creative design and production, to corporate presentation management.

Our teams have many years' industrial experience in the fields of Sales & Marketing, Finance and Information Technology in North America, Europe and Asia. This background allows us to quickly empathize with our clients to understand their markets, their objectives and to identify their business needs.

Through strategic planning and the creative application of our skills and experience, we deliver effective total marketing communications solutions, which meet, and typically exceed, their pre-defined goals and expectations. Operations are controlled from Montreal, Canada. From here we are able to provide service on a global basis in English, French, Chinese and Arabic to a diverse range of companies from start-up to established corporations.

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12 GLOSSARY PAGE

- **Accounts payable:** Amount owing to creditors for goods and services on an open account.
- **Accounts receivable**: Amount due from customers for merchandise or services purchased on an open account.
- **Asset**: Anything owned by a business or individual that has commercial or exchange value.
- **Balance sheet:** Financial statement that presents a "snapshot" of what the business owns, what it owes, and what equity it has on a given date.
- **Capital:** See Equity.
- **Capital expenditures:** Purchases of long-term assets, such as equipment, used in manufacturing a product.
- **Cash flow:** Incoming cash to the business less the outgoing cash during a given period. Also used to refer to the figure derived from net income plus non-cash items charged off in the accrual accounting process.
- **Collateral:** Assets pledged to secure a loan.
- **Collection period ratio:** Indicates how quickly your customers pay you. Average accounts receivable divided by net sales, multiplied by 365.
- **Community Reinvestment Act (CRA):** Under provisions of the Community Reinvestment Act of 1977, banks and thrift institutions seek opportunities to help meet the credit needs of their local communities, including low—and moderate—income neighborhoods, consistent with safe and sound operation of the institutions.
- **Compensating balance:** Money a bank requires a company to leave in a deposit account as part of a loan agreement.
- **Corporation:** Form of business ownership that is a legal entity on its own and puts stockholders and the board of directors in control. Owners have limited liability for the corporation's actions. A corporation has unlimited life and in most cases is taxed as an entity on its own.
- **Cost of goods sold:** Figure representing the cost of buying raw materials and producing finished goods.
- **Current assets:** Cash or other assets you expect to use in the operation of the firm within one year.
- **Current liabilities**: Debts you expect to pay within one year.
- **Current ratio**: Shows the firm's ability to pay its current obligations from current assets. Current assets divided by current liabilities.
- **Days purchases in accounts payable ratio**: Indicates how quickly you pay your suppliers for inventory purchases. Average accounts payable divided by the cost of goods sold plus change in inventory, multiplied by 365.

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- **Days to sell inventory ratio**: Indicates the firm's efficiency at matching purchases to expected sales. Average inventory divided by the cost of goods sold, multiplied by 365.
- **Debt ratio**: Indicates the firm's debt level, or leverage. Total liabilities divided by total liabilities plus capital.
- **Depreciation**: Amortization of the cost of a fixed asset, such as plant and equipment, over several years, or the "depreciable life."
- **Dividend**: Distribution of earnings to shareholders. Equal Credit Opportunity Act (Federal Reserve Regulation B): Prohibits lenders from denying your application on the basis of race, color, religion, national origin, sex, marital status, or age, or from discouraging you from applying, or giving you less favorable terms than any other applicant, on such a basis. Regulation B also contains specific rules governing credit transactions.
- **Equity**: The ownership interest in a business remaining after its liabilities are deducted. Also known as common stock plus retained earnings, or capital.
- **Extraordinary items**: Unusual or nonrecurring event that must be explained to shareholders or investors, such as a manufacturer's sale of a building.
- **Finance company**: Competitors of commercial banks in providing credit to households and firms. Unlike banks, they do not accept deposits.
- **Financial projections**: Estimates of the future financial performance of a firm.
- **Financial statements**: Written record of the financial status of an individual or organization. Commonly include profit and loss, or income, statement; the balance sheet, which includes a statement of the company's retained earnings; and the cash flow statement.
- **Fixed assets**: Long-term assets such as buildings, equipment, or property that are not expected to be converted to cash in the near term.
- **Gross profit**: Indicates the revenues of the firm before consideration of its operating expenses. Net sales less cost of goods sold.
- **Gross profit margin**: Measures a firm's profitability. Gross profits divided by net sales.
- **Gross income**: Net sales less cost of goods sold. Installment loan: Loan type that is paid in periodic payments, such as an automobile loan.
- **Inventory**: Value of a firm's raw materials, work in process, supplies used in operations, and finished goods.
- **Investor**: An individual who takes an ownership position in a company, thus assuming risk of loss in exchange for anticipated returns.
- **Leverage**: Measures the firm's use of borrowed funds versus those funds provided by the shareholders or owners (equity).
- **Line of credit**: Although not a contract, a bank's promise to lend to a specific borrower up to a pre-agreed amount during a specific time frame. Usually reviewed annually and subject to cancellation without notice.
- **Liquid assets**: Those assets that can be readily turned into cash.
- **Liquidity**: Gauges firm's ability to quickly turn assets into cash.
- **Marketable securities**: Securities that are easily sold.

- **Net income**: The sum remaining after all expenses have been met or deducted. Also called profit.
- **Net sales**: Gross sales minus returns and allowances.
- **Net worth**: Excess of assets over debt.
- **Niche**: Particular specialty in which a firm has gained a large market share.
- **Operating expenses**: Those costs associated with the day-to-day activities of the business.
- **Operating profit (loss):** Income or loss before taxes and extraordinary items resulting from transactions other than those in the normal course of business.
- **Operating profit margin**: Measures a firm's profitability by examining the pre-tax profit generated from primary operations (versus extraordinary items) in relation to net sales. Operating profit divided by net sales.
- **Partnership**: Can be general or limited, but in either case the general partners are in control. The tax burden is shared by all the partners at their personal rate, and the general partners have unlimited liability. Limited partners have limited liability.
- **Principal**: The currently unpaid balance of a loan, not including interest owed. Also can refer to a primary owner or investor.
- **Profit**: Compensation an entrepreneur receives for the assumption of risk in a business venture. Also called net income.
- **Profit and loss statement**: Summary of the revenues, costs, and expenses for a business over a period of time. Also called the income statement.
- **Pro forma financial statements**: Financial statements for a business where certain amounts shown are hypothetical, or estimated, for the period depicted.
- **Quick ratio**: Liquidity ratio that focuses on the firm's most liquid assets by excluding inventory. Also known as the acid test ratio. Cash, marketable securities, and accounts receivable divided by current liabilities.
- **Retained earnings**: Net profits kept accumulating in a business after dividends are paid.
- **Seasonal loan**: A loan made for the purpose of meeting predictable and periodic funding needs, such as funding of camping gear inventory before summer purchases. The loans may be used for working capital, machinery and equipment acquisition of real estate, and expansion.
- **Sole proprietorship**: A type of business where the owner has full control and unlimited liability. A sole proprietorship is taxed at the personal income tax rate.

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