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Financing For the Distributor

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Many people daydream of becoming a business owner. What separates the successful entrepreneur from the unsuccessful is often as simple as finding the money to turn the dream into a reality. Where to start? How to proceed? Unless you have that proverbial uncle with a sack of money, this can be a confusing, time consuming and frustrating process.

Finding the Money

Financing for a business is usually either debt or equity. Debt is borrowing and must be repaid. Equity involves selling an interest in the Business to investors. In deciding which direction you will take, consider these questions: how much control am I willing to give up… and how much debt am I willing to carry?

Debt financing will allow you, the Distributor, to retain control of the company, and hence its direction. It also gives you as the owner a measure of financial freedom; because, once the debt is repaid, the lenders have no further claim on your distributorship. What's the downside? First, monthly payments will add a sizable chunk to your expense sheet – and interest rates for the kind of loan you want are normally high. What could be an even bigger disadvantage is that obtaining debt financing for a new distributorship is often easier said than done. Remember the old adage, "a banker will only loan you money if you can prove you don't need it?" Unfortunately, that is often the case.

Equity financing offers one big advantage: You don't have to repay an investor on a regular basis the way you do a banker. What's more, since they have an interest in the business, equity investors will be more likely to listen to your ideas on how to run the business and what improvements are needed. The disadvantage: You have to give up some control of the business, because now the investor owns part of it.

Equity Financing

Sources for equity financing can be hard to find for a start-up distributorship. Depending on where you are at the launch point, you may be able to raise capital by approaching friends and associates with a well-put-together proposal. Also, consider high income professionals you know; they are often looking for opportunities to diversify their investments, and your kind of business may be just what they are looking for.

Look to your own personal network. Do you have a mentor or friend (or even a relative) who can steer you to a local individual or group that may be interested? What about your service club? What about your church, or your school friends or former clients you have stayed in contact with? Does your local chamber of commerce have a list of local investment groups?

Debt Financing

Debt financing sources include commercial banks, federal programs like the Small Business Administration, and personal debt such as credit cards and mortgage loans. These may be your **preferred form of financing**, but don't forget that they all involve repayment schedules, often high interest rates, and lots of paperwork (remember that adage about convincing the banker that you don't need his money!)

Banks

Most traditional banks prefer lending to distributors where most funds will be used to purchase fixed assets like fixtures, production equipment, or inventory. These offer collateral that the banker needs to secure the debt.

In some cases, you may be able to collateralize your loan, either fully or partially, with a second mortgage on your home, business or other property (please make this your last resort.) The lender may also ask for a personal guarantee. And in all cases, the banker is going to look for a well-prepared and professional-looking business plan, the kind of plan that says, "My desired business purchase is so solid that it's going to succeed with or without your help… so work with me now, and we'll both enjoy a profitable relationship in the future."

You may also find non-traditional banking sources that will meet your needs, such as lending syndicates, private lenders, and others, but be very cautious when entering this arena.

Small Business Administration (SBA)

The Small Business Administration (SBA) was established by Congress in 1953 with the specific purpose of helping new businesses meet their financial needs. It provides loan guarantees, along with business counseling and advocacy for small businesses in general. Eligibility standards vary, but generally, in order to qualify, your business must be independently owned (not part of some big conglomerate) and not be dominant in its field.

The primary SBA loan program is called Loan Guaranty. The SBA does not make loans itself, nor does it provide grants. Instead, it guarantees loans to small businesses that cannot obtain financing on their own. These guaranties reduce the lender's risks, because, in effect, they provide the collateral you may not have. The maximum size loan SBA can guarantee is $2,000,000.

Note, also, that the SBA does not provide "total financing." In order to qualify for a loan guarantee, you'll need to contribute about one-fifth to one-third of the total project cost on your own (this is called a borrower's capital contribution.)

Other Credit Sources

Because conventional business loans and even SBA guarantees are hard to obtain at best, and require a capital contribution on your part, you may have to obtain some part of your financing from other sources. Most of these are choices you'd rather not make, but they may be necessary in order to make your business ownership dream happen.

Friends and relatives: I once had a banker look at my balance sheet and tell me, "The only person who's going to help you with this is somebody who loves you." That hurt my pride, but it was a realistic assessment of my situation at the time. And it's not so unusual. Many entrepreneurs look to friends and family when starting out in a business venture. Often, this is the best way to get started, and sometimes the only way.

Home Equity Loans: These are the most common forms of loan used in buying a small franchise. This involves, of course, using your equity in your home or other property – either a first or second mortgage – as collateral for your start-up loan. You may have to do it, but think carefully before you do. You don't want to risk losing your home.

Credit Cards: Financing your business purchase by the use of personal or business credit cards is, as any banker or business advisor will tell you, never a good idea, that said, however, may find it necessary, at least to some extent. In fact, your bank (depending on how much you owe them) may offer you a business credit card at a favorable rate. Like using credit cards in your personal finances, this can be convenient, but risky.

Best advice? Don't use credit cards to finance your business purchase unless there is no other way.

Caveats

In obtaining any financing, you will encounter something called a "FICO" score. This is your personal credit score as assessed by the large credit reporting agencies and it is of the utmost importance. Your FICO score is a rating of your ability and willingness to repay a loan based on real and arbitrary data. The scoring ranges from 350 to 850, with the higher score indicating a greater likelihood of repaying and a lower risk of loss to the lender.

If your score is below 660, there is no point in going to the bank, because chances are you will be turned down. When you apply for credit, lenders want to know what risk they are taking, and they use FICO scores to determine credit risk. FICO scores have different names depending on the credit-reporting agency. Equifax calls theirs BEACON, Experian calls theirs Fair Isaac Risk Mode, and TransUnion calls theirs EMPIRICA. Taking steps to improve your FICO score can help you qualify for a small business loan.

If possible, never sign a personal guarantee. This will make you liable for business debts and can place your personal assets on the line.

How to Write a Loan Proposal

Approval of your loan request depends on how well you present yourself, your purposed distributorship purchase, and your financial needs to a lender. Remember, lenders want to make loans, but they must make loans they believe will be repaid. The best way to improve your chances of obtaining a loan is to prepare a written proposal.

A well-written loan proposal contains general information about the business, information such as its name, address, details of its legal structure, and its principals (owners). It will outline the purpose of the loan, why it's needed, and the amount requested. It will also give the history of Ecosafe, and describe its current operations. Detail current business assets along with a biography of each principal giving their background, experience, education, and any accomplishments they might have.

Next, identify your market, and define your product as it relates to your perceived market. List your competition and explain how your product or service is better. Give a profile of your customer and explain how your product or service can meet their needs.

Finally, include business and personal financial statements. Also, include a projected balance sheet and income statement along with information about any collateral you're willing to put up as security for the loan.

The Six "C's"

When reviewing your loan request, a lender will first order a personal and business credit report. Then, using the report, along with other information you provide, the lender will use the following six "C's" to evaluate your credit worthiness:

Character – What kind of person are you? The lender will first assess your character and dependability, based on your credit history. You want to make sure all previous debts have been fully paid, and if possible that you have no unlawful financial disputes in your history.

Capability – How competent are you? The lender must decide, from your appearance, manner, and history, if you are capable of running a successful business. Here is where a well-organized business plan will be valuable to you. If you have limited experience, it can be tough to get credit, so in this area your ability to market yourself is key.

Credibility – Is your idea likely to work? Before lending you money, the lender must assess the capacity of your business and its potential impact before considering any kind of credit. Make sure you can make a good case for the credibility of your business. ("This business will be able to serve the growing number of people who are buying high tech electronics gadgets but do not know how to set them up" is a good story. "Everybody will want one of our widgets" is not.)

Collateral – What can you put up to guarantee payment? The banker needs something tangible to guarantee that you will repay the loan. Collateral can include personal assets like a house or car; and the closer to the value of the loan, the more comfortable the lender will be.

Context – What, exactly, do you offer to the marketplace? If you are opening yet-another-jeans-store in the shopping mall, the banker may not be interested… but if you are offering something unique or new to the market place, they may decide to back your hand.

Conditions – Why are you asking for this money? The conditions under which you are requesting credit – your company's current financial status and your growth opportunities – may also be weighed before giving your Franchise a loan. "We need this loan to take advantage of a special opportunity" may work. "We need funds to rearrange our financing" may not.