



THE OHIO STATE UNIVERSITY

COLLEGE OF FOOD, AGRICULTURAL,
AND ENVIRONMENTAL SCIENCES

Business Financing 101

What It Takes to Borrow Money





Christopher Smalley
Business Development Specialist

The OSU South Centers
Business Development Network
1864 Shyville Rd.
Piketon, OH 45661
740-289-2071 Ext. 228
smalley.26@osu.edu



Financing is ...

- A means to accomplish short and long term goals for the business.
- A strategic tool to facilitate taking a calculated risk to obtain a future reward.
- For most, a necessary part of doing business today.

Financing includes ...

- Real Estate Loans, construction loans, credit lines, term loans & leases obtained from a traditional lender
- Overdraft protection on checking accounts
- Credit cards
- Trade accounts with suppliers
- Non-traditional sources, such as private individuals

A Good Banker/Lender is...

- A trusted advisor who is willing to LISTEN to your dreams and goals, and is not just out to sell a product.
- Has your best interests at heart for the long-term, even when the answer is something you may not want to hear.
- Can customize solutions to fit your needs (within prudent lending standards).
- Willing to help clients understand what they need to do to “get to the next level.”



A Good Customer ...

- Is honest with their banker and keeps him/her informed, especially when facing financial challenges.
- Provides complete and accurate information as needed on a timely basis.
- Recognizes the importance of maintaining good credit history & pays bills on time.
- Understands that the relationship must be mutually beneficial for both parties.
- Realizes their banker is not their enemy!



5 Basic Components of Credit Analysis

- **C**apital
- **C**onditions
- **C**haracter
- **C**ollateral
- **C**apacity



Capital

- Applicant's equity or net worth
- Owner's personal investment in company
- How much risk are you taking
- Can provide a "Plan B" repayment source
- Type of business – differences in needs





Conditions

- Local economic climate
- Other industries could affect your business
- What is the purpose of the loan
- Political influences/ history
- Competition



Character

- Check on your company's financial status
- Personal credit history/creatures of habit
- Experience
- Responsible company leadership
- Timeliness in fulfilling obligations



Collateral

- “Plan C” Repayment Source
- Anything of use for security of repayment
- Personal Guarantees
- Hard Assets, Accounts Receivables, Inventory, Goodwill
- Loan to Value Ratios



Collateral Discounts or LTV's



- “Are based upon perishability and/or liquidation value
- Allow “cushion” for potential fluctuations in value.
- Prior liens are subtracted after discounting to find net available value.

Typical discounted values for businesses -

- Inventory—40-50%
- Equipment—50-75% (age, condition, market?)
- Real Estate—75%
- Some inventory & equipment may have little or no value because of limited resale market

Capacity

- Repayment ability
- Ability to get repaid
- Cash Flow !
- Innovation, education, knowledge, experience
- Consideration of other liabilities



Common Sense

- What is the specific purpose?
- What amount do I need--not how much can I borrow?
- What collateral is available?
- How much cash can I put in the deal?
- Terms: What rate? How long? What is the estimated payment?
- Can I repay the loan?



How to figure Debt Service Coverage ...

(For Existing Business)

Part 1—Calculating funds available to service debt

$$\begin{aligned} & \text{Net Income from Sch. C or Form 1120/1065} \\ & + \text{Depreciation} \\ & + \text{Interest} \\ & - \text{Family Living Allowance if not in labor expense} \\ & - \text{Allowance for income taxes (actual or 30\%)} \\ & - \text{Allowance for normal capital expenditures} \\ & = \text{\$ \$ \$ \$ AVAILABLE TO SERVICE DEBT} \end{aligned}$$

How to figure Debt Service Coverage ...

Part 2—Calculating DSCR

Divide

\$\$\$\$ AVAILABLE TO SERVICE DEBT from Part 1
by Total Principal & Interest payments for 1
year, including any new proposed debt

Resulting number needs to be greater than 1.0,
preferably 1.25x or higher

Ratio <1.0 means insufficient cash is available to pay
debt obligations

Other things to know about Debt Service Coverage ...

- Also looked at on a “Global” basis -including personal debt and other significant businesses owned by client.
- Typically only 50% of outside (non-business) income is considered as “available” to cover non-business debt (if earner is on the loan).
- Usually calculated as a 3-year historical average.
- Major changes in operations—may use projections

Credit Check

- Hard inquiries
- Available balances on open accounts
- Payment history
- “Maxed Out” credit lines
- Debt to income



Consumer Credit

- Credit history
- Employment history/ earnings potential
- Stability (residency, personal reserves etc.)



Commercial Credit

- Commercial number years in business
- Type of business (retail, service, manufacturing etc.)
- Legal structure
- Location
- Seasonal vs. non-seasonal
- Area market, industry in general
- Management strength



Things that make your lender happy ...

- A down payment!
 - 20-25% is standard for most projects
 - More may be required for riskier ventures, such as restaurants and recreational enterprises (35%)
 - At minimum, 10% actual cash is required as part of the typical 20-35% down payment for SBA loans—usually cannot be borrowed money
 - Additional down payment required may be made up with equity in other assets; long term loans will require real estate equity

Things that make your lender happy ...

- Seller-financing does not count towards the SBA's 10% cash-down requirement
- Be prepared to put up your house!
- Collateral discounting previously discussed applies!
- Creditworthiness and relationship with borrower may impact requirement
- Good credit scores (>720)
- Debt Service Coverage Ratio >1.25x
- Profit on the tax return!
- Working Capital Ratio >1.25x



Things that make your lender happy ...

- Current Assets divided by Current Liabilities including current portion of long term debt
- Abundant collateral
- Equity (Assets – Liabilities) > Liabilities
- Adequate insurance to mitigate risks—property, life, health, disability, business continuation?
- Estate and succession plans clearly thought out and in writing
- Business agreements with partners in writing

Other tidbits ...

- Lenders can only base lending decisions information you report to the IRS.
- Clients must balance the desire to pay minimal taxes against the need to obtain current and future financing, including a cushion for growth.
- For a spouse's outside income to be considered in debt service calculations, spouse must usually be a co-borrower or guarantor.
- Poor personal credit history of the spouse can hamper the business's ability to get credit or increase rates.

Other tidbits ...

- Clients must balance the desire to pay minimal taxes against the need to obtain current and future financing, including a cushion for growth.
- For a spouse's outside income to be considered in debt service calculations, spouse must usually be a co-borrower or guarantor.
- If you have to be late on something, don't let it be a payment to the bank or something that's reported to the credit bureau.
- Bankruptcy is at least a 7-year problem.
- Late payment of taxes, particularly payroll taxes, is a MAJOR problem.



- All lenders are not the same
- Research various lenders, ask questions.
- Establish a relationship with your lender
- Different loan programs
 - Ohio Grow Now Program
 - SBA Small Business Administration
 - Gap Financers



Loan Package Checklist (1)

- _____ Business Plan
- _____ Market Research (where applicable)
- _____ Resume of Owner(s) and Key Management
- _____ Sources (bank loan, owner's cash equity, etc.) / Uses (building, inventory, working capital, equipment, etc.) of Funds include Annual Debt Payment of any Loans
- _____ Copy of Partnership Agreement, Articles of Incorporation, Articles of Organization
- _____ Copies of Licenses, Permits, Trademarks, etc.
- _____ List of collateral (with serial numbers where applicable), age, cost, current market value
- _____ Personal Financial Statements for Anyone with 20% or more Interest in the Business
- _____ Personal Federal Tax Returns for the Previous Three (3) Years for Anyone with 20% or more Interest in the Business

Loan Package Checklist (2)

- ___ Name, Address, Telephone Number of Business Attorney, Accountant, Insurance Agent, Business Consultant
- ___ Twelve (12) to Twenty-Four (24) Month Cash Flow Projection with Line Item Description
- ___ Three (3) years of Projected Annual Profit and Loss Statements
- ___ A Beginning Balance Sheet for Start-Ups or a Projected One (1) Year Balance Sheet for an Existing Business
- ___ Written Quotes on any equipment Purchases / Leases and / or Construction Costs
- ___ Copies of any Real Estate/ Other—Purchase/ Lease Agreements
- ___ Legal Description of Real Estate that is a part of the Business or to be used as Collateral
- ___ Recent Property Appraisals or Business Valuations of collateral (with serial numbers where applicable), age, cost, current market value



Loan Package Checklist (3)

- ___ EPA Related Documents
- ___ Letters of Intent from Prospective Customers
- ___ Profit & Loss Statements and Balance Sheets for up to the Previous Three (3) Years
- ___ Interim (within the past 90 days) Profit & Loss Statement and Balance Sheet
- ___ Company's Tax Returns for up to the Previous Three (3) Years
- ___ Aging of Accounts Payable/ Receivable
- ___ Contracts with Customers
- ___ List of Customers and Percent of Business each account for
- ___ Favorable Letters form Commercial Customers



\$\$\$ Websites of Interest

- \$ Treasurer of Ohio www.tos.ohio.gov
- \$ Ohio Development Services Agency www.development.ohio.gov
 - Has a variety of bonds, grants, loans and tax credits that can assist Ohio companies as they grow and create jobs
- \$ Finance Fund www.financefund.org
 - Connects local small business owners and entrepreneurs with public and private funding to help spark community development and create jobs.
- \$ United States Dept. of Agriculture www.usda.gov
 - *USDA Farm Service Agency www.fsa.usda.gov
 - *USDA Natural Resources Conservation Service www.nrcs.usda.gov
- \$ Small Business Administration (SBA) www.sba.gov
- \$ Ohio Valley Regional Development Commission www.ovrdc.org
- \$ Southern Ohio Ag & Community Development Foundation www.soacdf.net
- \$ Economic & Community Development Institute (ECDI) www.ecdi.org



Informative Websites of Interest

The Ohio State University South Centers	<u>http://southcenters.osu.edu</u>
Business Development Network	<u>http://southcenters.osu.edu/business</u>
Ohio Small Business Development Centers	<u>www.ohiosbdc.ohio.gov</u>
The Ohio Secretary of State	<u>www.sos.state.oh.us</u>
Ohio Business Gateway	<u>www.business.ohio.gov</u>
Ohio Department of Taxation	<u>www.tax.ohio.gov</u>
Ohio Department of Agriculture	<u>www.agri.oda.gov</u>
Internal Revenue Service	<u>www.irs.gov</u>
United States Dept. of Agriculture	<u>www.usda.gov</u>
*USDA Farm Service Agency	<u>www.fsa.usda.gov</u>
*USDA Natural Resources Conservation Service	<u>www.nrcs.usda.gov</u>



Questions or Comments??

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