Pathways to Prosperity: Navigating Capital Readiness for Arizona Entrepreneurs

Presented through The State Small Business Credit Initiative (SSBCI)

Presented by:

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State Small Business Credit Initiative (SSBCI)

The State Small Business Credit Initiative (SSBCI) is a nearly **$10 billion program** to support small businesses and entrepreneurship in communities across the United States by providing *Capital and Technical Assistance* to promote small business stability, growth, and success.

Arizona SSBCI Program

1 Access to Capital:

The Arizona Loan Guarantee Program (AZLGP) provides loan guarantees to partnering lenders for up to 50% of principal on loans to eligible businesses for startup costs, working capital, equipment, inventory, and the purchase, construction, renovation, or tenant improvements of an eligible place of business.

Businesses must be an eligible Arizona small business, or eligible non-profit, and have fewer than 500 employees.

The Arizona Commerce Authority is ***partnering*** with Clearinghouse CDFI, Lendistry CDFI, and Prestamos CDFI. The ACA does not make direct loans.

Arizona SSBCI Program

2 Venture Funding

The Arizona Venture Co-Invest Program makes direct equity investments in innovative seed- and early-stage businesses in targeted sectors alongside institutional/venture capital firms, established angel capital associations, corporate VCs and established accelerators and incubators. This program is administered through the non-profit Arizona Venture Development Corporation (AVC).

The Arizona Multi-Fund Venture Capital Program provides equity investments in established venture capital firms to attract new capital in innovative Arizona-based businesses. This program is administered through the non-profit Arizona Venture Development Corporation (AVC).

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Arizona SSBCI Program

3 Technical Assistance Program

This program is designed to ***prepare*** Arizona businesses for either debt or equity funding while also providing financial literacy training. This is not a loan program, but a capital readiness training program.

The goal of the SSBCI Technical Assistance (TA) program is to help prepare Arizona small businesses to understand what they need to do in order to apply for capital, understand the application and underwriting process, and to improve their understanding of financial literacy. Legal and Accounting support is also available.

Businesses can apply for no-cost technical assistance through the ACA website at https://www.azcommerce.com/ssbci/ssbci-technical-assistance-grant-program/

Webinar Objectives:

Participants will obtain a better understanding of Business Financing:

- ✓ **Debt Financing and Equity financing** Pros & cons of each one.
- ✓ **The Lending Process**-Its most significant components.
- ✓ "**Capital Readiness**" and how it is assessed by financial institutions.

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It is common that new businesses start and, at least for a certain time, develop with ***little*** *or* ***no external funding***. Eventually, however, financing will be required.

That is exactly what we will discuss today: Business Financing

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Business Financing

The process of funding business activities, purchases, or investments.

Also referred to as "access to capital"

Financing for Business - Two basic types:

1 Equity Financing:

Capital infusion in the business obtained through the selling of stake in the company. It is equivalent to selling “a part of the business”. Ownership is partially transferred to the investor, and the investor gets a stake in its success and has a say in how the business is run.

Pros:

- We do not have to pay back the money, investors are not creditors. Investors share the risk. Investors might bring expertise, contacts, and advice to help the business grow and succeed.

Cons:

- We give up part of the business, we have less control and forgo a percentage of future earnings. Investors are co-owners now.

Financing for Business - Two basic types:

2 Debt Financing:

Involves borrowing money and paying it back, usually with interest, over a fixed period of time. There are many different forms of loans and details are extremely important when making decisions about taking on debt financing.

Pros:

- Lender has no control over your business, once the loan is paid, the legal relationship ends. You know the cost of the capital up front.

Cons:

- You pay interest and fees, which can be costly. The natural risk of not being able to pay on time is a constant downside.

A more specific classification of ways to finance a business:

Equity Financing:

- Angel Investors
- Venture Capital firms
- Corporate Investors
- Partnering with friends/family

Debt Financing:

- Bank/Financial Institutions loans
- Invoice Factoring
- Crowdfunding
- Personal loans from family and friends

Prestamos CDFI

As a **CDFI** (Community Development Financial Institution) our role at **Prestamos** is to support small businesses and start-ups with financing via microloans, small business loans and SBA backed loans. Also, to provide technical assistance (TA) that helps entrepreneurs to better manage their businesses.

On many occasions, the combination of both of those essential services is the best formula for business owners.

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Essential Stages of a Loan Application

While the names of stages may differ by lending institution, we can break the loan process into three stages:

- **Application**
  - Provide all information and documents (Taxes, P&L, Business Info)
- **Underwriting Process**
  - Loan is reviewed against lender guidelines
- **Loan Closing**
  - Conditions met and documents signed

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What do lending institutions look at when reviewing and underwriting your loan application?

This can be better explained – and understood - through the "Five Cs of Credit", which include Capacity, Capital, Conditions, Character, and Collateral.

Let's check each one of them!

Capacity (Cash Flow)

Lenders must be sure that the borrower has the ability to repay the loan based on the proposed amount and terms, so they look at your “capacity” to borrow.

- Review Current P&L Statement and Balance Sheet
- Review Additional/Outside income
- Debt Service Coverage Ratios* (1.15 to 1.5)
- Understanding Other Debt Obligations (Balance Sheet)
- Future Projections (why do we need these?)
- Not putting undue stress on the business

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Capital

Lenders also analyze a borrower's capital level when determining creditworthiness. “Capital” for a business-loan application consists of personal investment into the firm, retained earnings, and other assets controlled by the business owner.

- Personal Investment (Capital Injection)
- Retained earnings (Cumulative net earnings or profits of a company after accounting for dividends or owner draws)
- “What is your skin in the game?” – When an owner is fully vested into their company there is an added incentive to give it 110% and not default on their obligation to the lender

Conditions

"Conditions" refer to the terms of the loan itself, as well as an economic conditions that might affect the borrower.

- Strengths and Weaknesses (Overall economy and purpose of loan)
- Uses of Funds – "Does your loan request make sense?"
- This factor is the most subjective of the 5 C's and is evaluated mostly qualitatively. Industry related – "Is your industry considered HIGH RISK?"
- Terms – Interest Rate, Term of Loan, Payment, etc. (Payments affect cash flow)

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Character (Credit)

"Character" refers to a borrower's reputation or record regarding financial matters. The old adage that "past behavior is the best predictor of future behavior" is one that lenders subscribe to.

- Verifying references (Personal and Business)
- Credit Score – "Knowing your score is crucial in any conversation with a lender". Most lenders require a Personal Guarantee and review personal credit.
- Bankruptcy – What type?
- Collections/Charge offs – (Medical Debt, Repossessions)
- Credit Usage – "Are you maxed out on credit card debt?"

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Collateral

Personal/Business assets pledged by the borrower as a security interest for their loan. “Collateral” can come in many forms.

- Real Estate – Residential or Commercial
- Equipment – Tractor, Industrial machinery, Vehicles (included Dump trucks, semi-trucks, Heavy duties)
- Lenders measure collateral quantitatively by its value and qualitatively by its perceived ease of liquidation
- Default? Collateral helps mitigate the perceived risk with any loan. The better the collateral the stronger the application

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Now that we have a good understanding of what financial institutions look at when receiving a loan application, are we ready to apply?

It is possible; however, it is extremely important that we also get familiar with the "Capital Readiness" concept, or, in the world of business lenders, "**Loan Readiness**". Let's see that now.

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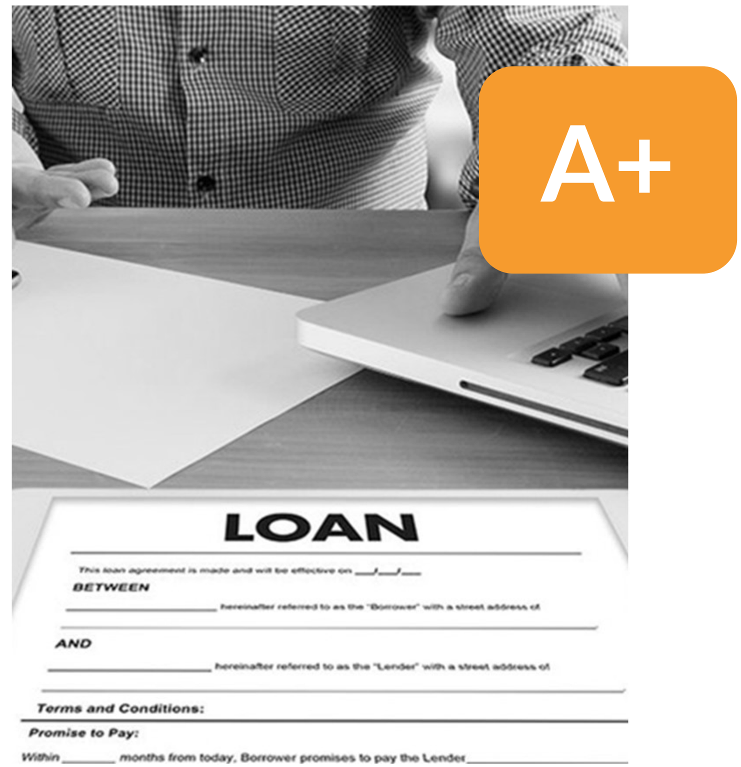
Loan Readiness

"**Loan ready**" is a qualification in relation to a businesses financial health and creditworthiness. If we say a business is "loan ready", we mean that the business is eligible to apply for a loan. *<u>It is certainly not a guarantee of approval</u>*, but it should be considered as the first step in the right direction.

"**Loan readiness assessment**" is the process of evaluating readiness. It is not necessarily a formal procedure. However, it is always done, and most of the time it is done through conversation.



Important things to keep in mind about taking on debt capital

A bad loan, a loan where the borrower ends up defaulting, is not only damaging for the lender, but also for the borrower. The road to recovery can be long and very difficult.

We should embrace initial loan readiness assessments and advice offered by financial institutions staff as something helpful and as part of their service. If a loan is possible, they will help you find the way!

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Small Business Owners & Loan Readiness

Many people who run very small businesses or who are just starting out believe that a loan can fix any problem they encounter. But the truth is, more money isn't always the answer.

Ideally, a loan should be used for:

- Growth/ expansion projects
- To take advantage of new opportunities offered by markets
- The purchase of equipment or other needed supplies and inventory.

What small businesses can expect when talking to a lender or other staff at financial institutions

First, you need to *be ready* and handle those initial conversations with the mentality that you are going through a loan readiness assessment. In other words, **preparation is the key**.

Understand that a lot of questions will be coming your way. You must *show patience* and answer in a straightforward, concise way, to the best of your ability.

Technical Assistance – Business Plans/Projections

The Do’s & Don'ts of Loan Readiness Assessments

What helps our cause:

- ✓ Show patience and understanding. Approach the conversation calmly and be open to the process.
- ✓ Keep your answers straightforward and consistent. Avoid giving conflicting information.
- ✓ Lenders are on your side. They're looking to give out loans, so if there's a way to approve your loan, they'll work towards it.
- ✓ Have all your business information ready to show. Whether it's on paper or digital, make sure it's well-organized and easy to understand.
- ✓ Keep in mind that a business loan is by nature something more complicated that a consumer loan, avoid comparing it with CC/Auto loans.

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The Do’s & Don'ts of Loan Readiness Assessments

What does not help, or hurt our cause:

- ✓ Not having an express purpose for your loan request and not having a very good estimation of the amount you need based in the business project
- ✓ Show that you are in a hurry, and you do not consider the conversation important
- ✓ Assuming and/or expressing that the “system” always works against you
- ✓ Not being clear in your answers, too many “if and buts” and obvious contradictions.
- ✓ Not being prepared, not having information on hand or having it in a very disorganized way.

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Additional Preparation:

- Be able to explain what you need the money for. Understand how much you need, and be prepared to justify how you determined that amount.
- Match your excitement with the real details of your project. Keep it realistic and stay away from overstating or guessing outcomes.
- Remember that the loan process can take several weeks or even months depending on your lender. Preparation and patience are key. It is important to start the process way before you actually need the financing.

Other important notes

- Remember, business loans are usually not granted for covering overdue expenses like back rent or late payroll.
- Remember that it will be highly probable that you will be asked to be a personal guarantor of your business loan. This is common on most loans.
- You might also need to contribute your own funds to the business — this shows lenders you're committed.
- Keep your financial documents, like Profit and Loss statements and Balance Sheets, up-to-date and ready to share.

Next Steps and Resources for Capital Readiness

Businesses can apply for ***no-cost*** technical assistance through the ACA website at https://www.azcommerce.com/ssbci/ssbci-technical-assistance-grant-program/

Learn more about the ACA SSBCI Loan Guarantee and Equity Programs by visiting the SSBCI Website at https://www.azcommerce.com/ssbci/

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Questions ??

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