

FAQs in Financing Your Project

1) What is the minimum requirement for owner equity in a project?

That depends on a lot of factors: the characteristics of the new product or service, type of equity you have to offer, your past experience in the market place, financial strength of any guarantors, etc. You should use 20% of the total project cost as a good rule-of-thumb starting point. But that 20% can take many forms, such as subordinate debt or liens on other property not necessarily relevant to this project.

2) How much detail do I need when listing my assumptions in the financial section?

This one can be a little tricky. The optimal amount of disclosure provides the significant assumptions you used, without getting too mired down in unnecessary detail. The danger in providing too much detail is that it gives the loan analyst more information to digest, and question. The more questions the analyst has, the longer it takes before your request even gets before the loan committee.

3) How do I know if I'm asking for enough money?

You need to ask for the amount of capital it will require to get your project constructed, equipped and operating, and enough working capital to carry you to the point where you are making enough money to pay all of your operating expenses, and can start repaying your debt. Most projects will require working capital equal to 3 – 6 months of operating costs. But this estimate varies greatly by the type of project, whether you already have signed sales orders and the payment terms of those contracts.

4) What is venture capital and how does it differ from bank loans?

Venture capital money is essentially equity. Venture capital money becomes a component of the equity base of a company in exchange for ownership in the company. Bank financing is purely credit. Venture capitalists are looking for companies they believe can rapidly generate substantial profits, resulting in high returns to the owners, followed by an attractive exit strategy. The bank's main concern is repayment of the loan principal and interest, and holding a sufficient amount of collateral to cover its' loan should the loan not be repaid. The venture capitalist's position is collateralized as an owner, resulting in a higher level of investment risk.

5) I'm having trouble getting a bank loan, what do I do now?

There are economic development loans available from the Small Business Administration, United States Department of Agriculture, West Virginia Economic Development Authority, West Virginia Capital Corporation, and County and Rural Economic Development Authorities. These groups will provide project financing through direct loans where conventional lending has been denied, or subordinate loans or grants that will help satisfy your equity requirements and make it possible for you to obtain financing from your own financial institution.

6) What are the most common pitfalls you've seen in project financing?

The most common pitfalls can be grouped into a just a few categories: (1) problems with the business plans; (2) problems with financial projections; and, (3) problems with the applicant. Problems most commonly seen in the preparation of the business plans are

usually that the documents don't convey to the potential lenders that the applicant has done their homework in evaluating all the aspects of financing their project. There are too many open questions, or the questions are answered with "I don't know". They also include inadequate management experience, and no analysis of market, industry and competitive factors. Problems with the financial projections include negative cash positions projected after working capital has been depleted, inadequate documentation of assumptions, mathematically and systematically incorrect flows of cash, and missing cost components of production or sales. Problems with the applicant include past financial difficulties (bankruptcy, for example) where mitigating factors have not been offered, and the applicant isn't willing to negotiate with the potential lender (management issues, for example).

Most of these problems can be easily avoided by having a professional review your business plan and projections prior to submitting them to a potential lender. These are referred to as soft costs and can include the fees of accountants and lawyers. You can usually be reimbursed for soft costs with loan proceeds. These professionals can offer you suggestions and perform a sanity check of your calculations and assumptions. Engaging a professional to help you secure your financing after you have submitted your plan may be too late. You should seriously compare the costs of engaging a professional before you submit your application, to the additional costs resulting from higher lending rates.

7) Should the statements in my financial section be on an annual, quarterly, or monthly basis?

Generally, your financial statements should be on a monthly basis for the first year or two, depending on when you anticipate you will achieve your break-even point. After that you should provide quarterly statements. We suggest you use these guidelines in order to provide a total of five years financials in your business plan.

8) What do you mean my financial statements should be as realistic as possible? Wouldn't it be better to present everything on a very conservative basis?

There are problems with preparing your financial estimates either too aggressively or too conservatively. The problems resulting from aggressive projections are obvious. Overly conservative projections could cause your project to be given a higher risk classification, resulting in higher interest rates, more stringent equity requirements, or ultimately, loan denial.

9) What if I run out of money?

You have to ask for more. But it's not always as easy as that. Lenders are normally very concerned when approached for additional funding before a project is completed, and rightly so. There are two components to the amount of money you will need and it is very important to carefully calculate both of those amounts. You will need enough capital to construct and equip, considering an amount for contingencies (cost overruns for example) in that estimate. And then you need to determine a sufficient amount of working capital that you will need to be able to operate while your operations and cash flows are ramping-up to full production/sales. We cannot over-emphasize the importance of securing a sufficient amount of funding at the outset of your project.