








Preparing A Financing Proposal

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1. What is the client looking for?

Before a client can approach any Banker they must have a clear idea of the financing that they are looking for.

- What will the financing be used for? Purchase fixed assets, working capital, refinancing, change of ownership (shares or assets)?
- Most importantly, how will the project benefit the business? Can this benefit be quantified? i.e. % market share, $ sales growth, $ profit?
- How much does the client need, are costs firm, and when does the client need the money?
- Has a contingency reserve for project cost overruns been established?
- What type(s) of loans are required (demand, term, mortgage), for how long and on what terms?
- How much is the client willing to personally invest in the project?
- What are the other sources of financing for the project, if any, working capital, other lenders, government grants, the seller (balance of the sale), and deferred or postponed loans?

2. What is the banker looking for?

If you know what a Banker is looking for it is much easier to present a solid and persuasive case in support of your loan application. How do Bankers make a decision? Generally commercial bankers will use the following four criteria to assess the proposal:

Management:

The caliber and relevant business experience of management is of paramount importance when assessing the creditworthiness of any business.

- What is management's background and experience in the industry or other industries?
- What is the caliber of the management team - does the management team have the collective knowledge, skills and experience to be successful?
- Can management successfully plan the future and identify the resources required?
- Is there continuity of management? Is there a written succession plan?
- Are there independent opinions of management's abilities, character and adaptability available?
- What comprehensive management information systems are used in the business?
- Has management had previous borrowing experience with the Bank? Has it been positive?

Earnings (repayment capacity):

It is fundamental that Bankers lend only to businesses which can realistically be expected to generate sufficient cash to meet the foreseeable needs, i.e. repayment of debts (principal and interest) as they fall due, replacement of fixed assets, and to maintain working capital at a viable level.

- Is the project viable?
- What is the payback period of the new project, i.e. savings, productivity enhancement, etc.?
- What is the historic performance of the business and how does it compare to industry standards?
- Are the forecasts reasonable and achievable based on historic results and current industry and economic trends? Impact of sensitivity analysis?
- Does the business have the capacity to repay current debt and the proposed new debt from earnings?
- What is the consistency and sustainability of cash flow, debt service and working capital requirements?

Investment:

The borrower's investment must be sufficient to ensure an on-going commitment to the business, and to ensure that the borrower would support the business to the utmost in spite of severe adverse developments.

- What investment are the owner/shareholders making in the project?
- What is the source of the investment and when is it available?
- What is the current financial strength of the owner/shareholders and do they have access to additional resources?
- Is there sufficient equity in the business and how does it compare with industry norms?
- What are the other sources of investment available? Grants, subsidies, third party investments?

Security:

The potential on-going success of an operation can be accessed through the preceding criteria. Security for a loan represents a "fall back" position for a lender, providing a level of comfort for the risk undertaken.

- What security is available to support the loan? Accounts receivable, inventory, equipment, machinery, furniture, land, buildings, guarantees, etc.?
- What is the age and condition, of the security? Are there other factors which may affect the value of the security, i.e. technology advances, zoning changes, environmental implications, etc.?
- Are there professional appraisals to back up the value?
- Is the security easy to sell in the event of default?
- Is the security value on a liquidation basis sufficient to adequately secure the loan?
- Do other lenders have claims against the assets?
- What personal and/or corporate guarantees are available?
- What are the means of the guarantors to cover their guarantees?

Other issues which may impact the Bankers decision:

Environment:

- How does the business or its business practices impact the environment?
- Does the realty being purchased have any environmental risks?

Lending Policy:

- Are there lending restrictions on providing loans to specific higher risk industries, types of businesses, industry sectors, types of financing, etc.?

3. What information is required?

Ideally, the Banker would like to receive a complete and concise business plan. This would include, but not limited to, an executive summary, description of the company and operations, management, marketing plan, production plan, human resources plan, and comprehensive financial information. The proposal, depending upon type of financing requested may include the following financial information:

Financial Information Checklist:

- Statement of Personal Net Worth for all major shareholders
- Financial statements for the past two to three years
- Interim financial statements (include same period for previous fiscal if available for comparison)
- Monthly cash flow Cash flow forecast for at least two years. If possible a sensitivity analysis (best case, realistic and worst case). Required for operations with cyclical fluctuations, for start-ups, working capital projects, and major projects. Projections would normally be one to three years depending upon the length of time required to achieve full operation.
- Aged listing of accounts receivables and payables for last year-end and most recent interim.
- Forecast of income and expense for two years, including assumptions
- Financial statements for all related companies for which the borrower has advanced funds if significant.
- Consolidated financial statements where applicable

Depending upon the project, other information may be required, but not limited to the following:

- Purchase sale agreements
- Leases
- Firm cost estimates for equipment, building construction, etc.
- Drawings and specifications
- Building permits, licenses, etc.
- Contracts with buyers
- Survey plan
- Appraisals – realty and equipment
- Detailed list of assets – land, building and equipment, etc.
- Breakdown of sales by major product category
- Inventory summary listing
- Management Resumes

4. What is involved in preparing an effective proposal?

- Present one project. Bankers prefer one clear and complete project to many excellent but vague possibilities.
- Focus on the key areas that the banker will “need to know” versus “like to know” in order to make a decision.
- Write simply and present your case – put yourself in the reader’s shoes. Avoid long sentences, complicated words and technical jargon, as this will not impress your banker.
- Back up your proposal with facts (research information is invaluable) and include such reports as appendices.
- Time is of the essence – a short and concise proposal will be to your benefit to elicit a quick response.
- Your proposal should look professional to provide the Banker with a positive first impression of your company.
- Demonstrate how you will repay the loan. Your forecasts should prove how the project would be profitable for both you and the Bank.
- Demonstrate how you will succeed. Show how you have considered all of the angles and that you do have a contingency plan. Also indicate how your previous successes or experience will help with the current project.

5. How do you deal with bankers?

- Work with your Banker – you are both on the same side.
- Bankers are, almost by nature, cautious and conservative – therefore full disclosure is required to maintain Banker's confidence and trust.
- Arrange your borrowing needs well in advance, this reflects favorably on management's ability to effectively plan for future growth, which bolsters your case for a loan.
- Help your Banker reach a quick decision by providing a solid rationale for the loan and demonstrate how the business can repay it.
- Understand what you Banker will be looking for and have pertinent supporting documents and other information readily available.
- Prepare a convincing and complete proposal – sell yourself and the potential of your business to succeed.
- Establish a good rapport with your Banker; keeping him/her up to date on your business, providing timely annual financial statements, etc. as this will assist to expedite future requests for financing.
- Improve your understanding of the financial institution you are dealing with, the types of loan products and services offered by reviewing their website.

"The Bankers role is to finance your project, not to plan it for you. If you have not taken the time to plan properly, your Banker is unlikely to lend you the money"

6. For more information

Innovation PEI specializes in providing one-on-one business advisory services. Our qualified staff can also provide information regarding most business development programs offered by government agencies across Prince Edward Island. Application forms and additional program information can be obtained from Innovation PEI.

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