Focus on Small Business

INSIGHTS AND INFORMATION FROM TD CANADA TRUST SMALL BUSINESS BANKING

Financing your franchise through the bank

Whether you are financing a new franchise or renovating an existing one, there are many avenues you can turn to, including personal savings, family and friends, bank loans, and venture capital. Many new franchisees choose a bank loan because it lets them retain control and ownership of the business. So how should you go about obtaining bank financing?

Where to start?

Once you decide to buy or renovate, approach the bank as early as possible, thus giving it sufficient opportunity to conduct a review. The bank will let you know what information is required to complete the application process, but in your introductory meeting, you will likely discuss the following:

- The type of project you are pursuing, e.g. a purchase or renovation, specific type of franchise system, its name and location;
- The total cost of the project;
- The amount of money you have to invest;
- The amount of money you will need as working capital for day-to-day transactions;
- Your income, expenses, and cash flow; and
- Your personal financial situation, including personal net worth, personal credit history, spousal income, etc.

Your franchisor may provide you with some of this information, such as estimates of the cost of your new location or renovation.

Which bank should you choose?

Although many banks provide franchise financing, it is wise to choose one with which you can build a lasting relationship. Consider the following factors when making your selection.

Franchise banking experience and industry knowledge. Be sure to select a bank that has experience working with your franchise system and industry. To determine this, ask to speak with a small business banking advisor or franchise banking specialist.

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Flexible banking hours. New franchisees almost always work long hours. Therefore, try selecting a bank branch with long operating hours and/or weekend hours, so you can count on getting the service you need at the time most convenient for you.

Convenient banking channels. It is always helpful when a financial institution can adapt to your method of doing business. Your bank should offer you alternative methods, such as night depository services and automated banking machines (ABMs), along with Internet and telephone banking.

Location, location, location. Your bank should not only be convenient for your current location, but also have an extensive network of branches. Branches with dedicated business-banking tellers will save you time and the aggravation of teller lines.

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What financing options do you have?

Banks can offer a number of different credit products to help you achieve your franchising goals. The bank's small business advisor can help you understand which product, or combination of products, best suits your needs. Here are some of the most common bank-financing options:

Canada Small Business Financing (CSBF) Program. Guaranteed by the federal government, the CSBF program is available to most new and existing small businesses and franchises across Canada. A CSBF loan allows you to finance up to 90% of the cost of eligible asset purchases and renovations. Although these loans can be more expensive than other types of loans, your personal liability is limited to just 25% of the original amount borrowed. This means fewer assets are at risk if the business faces financial difficulty.

Commercial mortgage. If you own, or are purchasing, the real estate property of your franchise business, you may consider a commercial mortgage. In many ways, a commercial mortgage works just like a residential mortgage. You provide the lender with a mortgage on the property being purchased or financed, then pay a fixed amount of blended principal and interest each month to the bank. Be careful, though — commercial mortgage rates are usually higher than residential ones, and the amount you may borrow relative to the value of the property is usually limited to 75%.

Home-secured lines of credit. Many small business owners have built up equity in their homes. This, combined with the flexibility of being able to borrow and pay back the principal on the line of credit whenever cash flow permits, makes a home-secured line of credit attractive for borrowers. Home-secured lines of credit also have one of the lowest interest rates available to franchise owners.

Operating lines of credit and credit cards. Operating lines of credit and credit cards are some of the more expensive financing options. You should definitely have them available in the event of shortfalls in your day-to-day cash flow, but they should not be used as a major source of capital for your franchise purchase or renovation.

What are banks looking for?

After your initial meeting with the bank, you should have a better understanding of what products are best for your needs. At this stage, you need to prepare a detailed package of information to accompany your loan application. Your information package should include the following:

Your business plan. Your detailed business plan demonstrates why you are getting into this new business and how you will make it work. If purchasing or renovating an existing business, you should also provide historical financial statements for the last few years, as well as a copy of the purchase and sale agreement. If you are leasing your premises, the bank will also require a copy of the lease agreement. Banks also require a copy of the articles of incorporation and trade-name registration.

Your personal information. As a franchisee, you are the only one executing your business proposal. The bank needs to understand your personal situation and how you'll likely perform as a small business owner/operator. It is often wise to provide a resumé summarizing your work experience, accomplishments, training, and formal education. Include a personal net worth statement in the information package to help the bank understand your financial strength as a borrower. Most banks can provide you with a standard form to complete, but you can also prepare your own. Be sure to list all of your assets (indicating if they are owned jointly), and all of your financial liabilities and obligations (including credit cards, mortgages, car leases, family or child support payments, etc.). The bank regards your personal credit history as an important factor in evaluating the future success of your business.

Your franchise system. Banks will normally request information regarding your franchise system in order to get a better understanding of the kind of support your franchisor will be providing you with. Both the franchise agreement and letter of acceptance can also be required from the franchisor.

Your security. Your bank may seek security over and above a charge on the business assets being financed. The type and amount of security required varies, depending on the type of loan needed, and whether or not the bank has a franchise-lending program in place for your franchise system. Discuss the security package with your banker to ensure you understand exactly what you must provide to secure the loan. The following are common pieces of security you could be asked for:

- **General security agreement.** This represents a floating charge over all business assets. It is among the most common pieces of security and is generally taken for all loan types. The security is registered under the *Personal Property Security Act* (PPSA).
- **Personal guarantee from you and your spouse.** Where applicable, this is a basic bank requirement. Guarantees may be limited or unlimited. If unlimited, you are responsible for the full amount of indebtedness at any given point in time.
- **Collateral mortgage.** This can be taken over any type of real property, including your business, house, or cottage.

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How do you complete a business plan?

Many banks and franchisors can provide you with a template for completing a business plan, though you should seek help from an accountant or franchise consultant. Generally, good business plans consist of two parts: a business model and a financial plan.

The business model. The business model will answer two essential questions:

1. What are you providing to consumers that they are willing to pay for?
2. How can you do this profitably?

For example, a restaurant that provides low-cost food at affordable prices will have to generate a high volume of customers to cover its fixed costs and to make a profit. The business model must also demonstrate your understanding of your customer, the industry, the competitive landscape, and market trends. Be forthcoming about the strengths of your plan, but also its weaknesses, making sure to explain how you plan to address and solve them.

Financial plan. The financial plan normally consists of three key documents: the balance sheet, the income statement, and the cash flow statement. Successful financial plans make reasonable assumptions and present them clearly. From the financial plan, your bank will gain an understanding of your business' potential for profitability, day-to-day operations/expenses, and break-even points. The bank can also help you identify any financial gaps you might need to consider. For example, you may need to invest more of your own money to start up, or set aside more savings to cover potential cash flow shortfalls.

Almost all lenders stress the importance of a thorough business plan. A good business plan not only helps you to get the financing you need, but can also serve as the "road map" toward your continued success. Even if your business does not operate entirely as you anticipated, the business plan should be reviewed regularly so you can understand how your business is doing relative to it. Armed with this knowledge, you can make the necessary adjustments to both the business and your plan.

Your big meeting

Now that you have made your major business decisions and supported them with a business plan, you are ready to start the application process with your bank. Prior to meeting, provide the bank with a copy of your business plan so the banker has a chance to review it. At the meeting, be ready to answer questions about your plan and assumptions. You should confirm with the bank the type of financing required, and do your best to understand the kind of security and documents needed. The bank will also tell you how long you will have to wait for a formal response.

Closing the deal

Once the bank approves your application, you are ready to sign on the dotted line. You will be presented with a document to be signed outlining the types of loans you have been approved for, the interest rates, fees (if any), and repayment terms, along with other terms and conditions. This document is usually called a "credit agreement," and it is crucial for you to understand its terms. Failure to comply with any of them could result in the bank demanding repayment of your loan.

What if you get declined?

Don't panic! Many clients who are declined the first time are approved after further discussion. Evaluate the rejection with your banker and make sure you fully understand why you were turned down. An experienced small business advisor can provide you with suggestions on how to strengthen your application. You may also need to request a smaller loan and invest more of your own cash.

A few final words

The financing requirements for your business may be constantly evolving. Down the road, you might need additional financing for a renovation, new equipment, expansion of your business, or additional locations. Hence, it is essential to develop a strong and honest relationship with your banker, who can then provide you with the best advice for your situation.

For all your small business banking needs, please visit your local branch or www.tdcanadatrust.com/smallbusiness

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