

## **BORROWING FROM FINANCIAL INSTITUTIONS: YOU SHOULD KNOW THAT...**

- You must have a well developed , detailed business plan.
- You will need to have collateral.
- You should have equity of about 20%-25% of the amount you want to borrow.
- You will have to pay interest.
- Long-term credit at reasonable rates of interest may not be available.
- The institutions want to know that you
  - are in the habit of saving on a regular basis.
  - have a sound credit history.
- Application procedures may be cumbersome and present difficulties for someone with limited literacy skills.

## **FINANCING DO'S AND DON'TS**

- Don't borrow more than you NEED.
- Don't overestimate your borrowing potential.
- Don't overlook available financing.
- Don't underestimate the financial risks associated with your business.

- Don't neglect to manage the relationship with your lenders.
- Do forecast the cash needs of your business and yourself.
- Do know the reputation of investors before you accept their money.
- Do your loan application when you have time.
- Do learn how to manage the finances of your business.
- Do pay back money that you borrow from friends, relatives and financial institutions.

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# Centre for Enterprise Development Inc.

## BUSINESS GUIDE NO. 6

### *Financing Your Business*

*"Developing the local economy, one  
business at a time"*



## THE NEED FOR FINANCE

Businesses need money for one or more of the following reasons:-

- To put the basic infrastructure in place.
- To get the trading activities of the business moving.
- Acquiring capital equipment.
- Purchasing inputs.
- Carrying out marketing activities.
- Paying staff.

## SOURCES OF FINANCE

There are several sources of financing that are available to entrepreneurs. These include:

- i. Personal Savings:* Assets which can be used as leverage in securing other funds.
- ii. Friends and relatives:* This is often called 'love money'.
- iii. Banks:* Commercial and Development\
- iv. Credit Unions*

### v. Partners

*Silent Partners: Own a percentage of the business but does not play an active role in the day-to-day operations. You are able to maintain control over your business.*

*Active Partners: Play a role in the business.*

### vi. Investors

### vii. Suppliers

### viii. Potential Customers

### ix. Government Special Programmes

## SOME THINGS TO NOTE WHEN DECIDING ON A SOURCE OF FINANCE

- Loans from banks and credit unions must be paid back with interest over a predetermined time. You must not only have collateral but you must be able to repay the loan as well.
- Having a partner
  - Adds needed resources and skills to your business.
  - Gives you someone with whom you share failures and successes.
  - Prevents you from having full control of your business.
- *Term Loans:* taken for a specified period of time.
- *Trade Credit:* a supplier sells you products on credit.
- *Line of Credit:* operates similarly to a credit card but has a lower rate of interest.



## LENDING CRITERIA— THE FOUR C'S

**i. Character:** The financial institution assesses you and the business' past financial history and history and credit rating.

**ii. Capacity:** The lending agency determines if the business is capable of making projected profits and marketing its products, has a healthy cash flow and realistic projections.

**iii. Conditions:** General economic conditions.

**iv. Collateral:** Security against the amount of money that is borrowed. It can take the form of the business' or owner's assets.

## WHEN BORROWING FROM FRIENDS AND RELATIVES: SOME BASIC GUIDELINES:

- Identify the right person to borrow from.
- Avoid taking money from persons with ulterior motives.
- Put the agreement in writing.
- Treat all friends and family members as business associates.
- If necessary, choose a legal structure that would prevent them interfering in the day-to-day operations of the business.
- State
  - how much money you need to borrow;
  - what you will be using the money for;
  - how and when you will repay the loan.
- Show how much you anticipate the loan will make and what they can expect to receive once the business gets going.
- Do not accept more than a reasonable percentage (about 1%) of your friend's or relative's savings.