CHI ISHOBAK

SMALL BUSINESS LOAN GUIDE

Weaving a pattern of **economic independence**
into our lives today
for **future generations** tomorrow.

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This guide is not to be considered legal advice. It is for informational purposes only.

ABOUT CHI ISHOBAK

Chi Ishobak (pronounced Chee-ish-oh-bock) means "Big Cabbage" in Pokagon and is a Certified Native Community Development Financial Institution (CDFI). Chi Ishobak is a 501(c)(3) non-profit organization that was established to offer products and services to build capacity for Tribal Citizens in the areas of professional and personal finance.

We are here to help you succeed. It is the mission of Chi Ishobak to provide Tribal Citizens with access to affordable capital for the purposes of small-business loans and individual financial development through collaborative and education-oriented lending services, and to practice responsible lending in order to protect loan capital for future generations of Tribal Citizens.

Chi Ishobak will carry out this mission with a sense of pride in ourselves and in the people we serve as a Native community, with the aim to empower Tribal Citizens to build their ability to provide for themselves and create meaningful lives, and at all times Chi Ishobak will strive to carry out its responsibilities and succeed in its goals with the utmost integrity.

Chi Ishobak has developed technical assistance programs and partnerships for both the aspiring entrepreneur as well as the established business. For aspiring entrepreneurs, Chi Ishobak helps clients evaluate business ideas and establish a plan to turn those ideas into reality. Once your business is operating, new opportunities for growth and development will arise. Training and one-on-one assistance can help make your small business grow more efficient, more productive, and more profitable. Either through one-on-one consultation, mentoring, or workshop instruction Chi Ishobak provides assistance with most key business topics.

ABOUT THIS GUIDE

Chi Ishobak prides itself in nurturing Tribal entrepreneurs with access to capital for small-business start-up or expansion. Loans may range from $1,000 to over $35,000. Funds may be used for equipment, inventory, supplies, and/or working capital. Chi Ishobak will guide you through the process of acquiring funding for your business. Tribal entrepreneurs and business owners may not fully understand the intensive process that is required to approve a loan.

This guide was written to provide a roadmap and set expectations for tribal citizens seeking a small business loan. Whether the loan will be used for a start-up or to expand an existing business, the process requires a thorough look into the business or proposed business and requires documentation sufficient enough to allow the Chi Ishobak loan committee to develop a strong opinion of the risk involved in lending to the business.

This guide will allow tribal citizens to understand the process that the loan committee undertakes when reviewing a commercial loan application. It is hoped that it will provide sufficient information to navigate the Chi Ishobak loan process.

THE CHI ISHOBAK COMMERCIAL LOAN PROCESS

As a Certified Native CDFI, Chi Ishobak is able to provide commercial loans to tribal entrepreneurs and tribal citizen owned small businesses. Although we can be much more flexible than traditional sources of financing, we still require most of the same documentation and must perform exactly the same due diligence during the underwriting process to mitigate the risks involved in commercial lending opportunities. We never want to discourage a tribal citizen from pursuing an opportunity that could have an impact on themselves, their family, and their community. We do want to help them understand the process and the effort it takes to complete the process successfully.

Below is the basic process.

1. Initial Inquiry
2. Review Small Business Loan Guide
3. Complete & return Intake Form
4. Complete & return Readiness Assessment
5. Referral to the Small Business Development Center
    a. Business plan assistance
    b. Financial projection assistance
    c. Loan Package assistance
6. Submit Completed Application and Loan Package with application fee
7. Schedule loan committee presentation
8. Loan Committee Presentation
9. Follow-up on any conditions
10. Closing
11. On-going technical assistance

EQUITY INVESTMENT

Although the equity investment in a business can vary greatly, tribal entrepreneurs and small business owners should have a reasonable amount invested in their business to receive favorable consideration for a loan. This ensures that, when combined with the borrowed funds, the business can operate soundly.

During the underwriting process the loan committee will examine the business' debt-to-equity ratio to understand how much money Chi Ishobak is being asked to lend relative to how much the principals have invested. The smaller the ratio, the stronger the company, and the more likely the loan would be approved.

Each industry has its own benchmarks for low, moderate, and high debt-to-equity ratios. Within each industry there also may exist segmentation based on factors such as revenue size, location, years in operation, franchise/non-franchise, etc. Industry advocacy organizations often maintain metrics, including debt-to-equity ratios. Small business owners should be aware of their debt-to-equity ratio relative to their industry prior to applying for credit in order to fully understand the impact that borrowing will have on the business.

Sample Debt-Equity Ratios - Retail Sector

	3 QTR 2015	2 QTR 2015	1 QTR 2015	4 QTR 2014
Debt-to-Equity Ratio	0.76	0.82	0.19	0.71

Source: http://csimarket.com/industry/industry_Financial_Strength_Ratios.php?s=1300

Principals can invest assets that contribute to the operations of the business and /or invest cash which can be used to acquire such assets. The value of invested assets is substantiated either by invoices or appraisals.

Strong equity with a moderate to minimal debt level can produce a debt-to-equity ratio well below industry average. Under these circumstances the principals have provided the business with an improved ability to sustain itself during tough times. In contrast, a small business that has minimal or non-existent equity has a higher risk of default – particularly during difficult periods.

Strong equity investment demonstrated to Chi Ishobak shows that the principals are very committed to their business. Sufficient equity is particularly important for new or expanding businesses as there is a period of time after start-up or expansion in which the business is not yet profitable and will require the ongoing financial support of the principals.

Weak equity investment come with increased risk. However, low equity in relation to existing and projected debt can be overcome with a strong showing in all the other credit factors. Non-existent equity can make obtaining a loan almost impossible, as the principals have not shown a commitment to the business.

Determining whether a company's level of debt is appropriate in relation to its equity requires analysis of the industry, the company's expected earnings, and the viability and variability of these earnings. The stronger the support for the projected profits, the lower the risk, and the greater the likelihood that a loan will be approved. Applications with high debt, low equity, and unsupported projections are prime candidates for loan denial.

A Story of Two Investors

Peter and Bobby were vintage toy fanatics, their dream was to open a vintage toy store. One day they decided it was time to open the store and live out their dream of business ownership. Peter had a toy collection that was appraised at a wholesale value of $15,000. Bobby, choosing to be a 50% partner, invested $15,000 cash in the business. Peter's wholesale contribution went directly to inventory and Bobby's cash went to other purposes, including renting a store front, paying for store fixtures and advertising. Peter and Booby also received a loan for $20,000 for working capital purposes. With debt of $20,000 and equity of $30,000, the business had a debt-to-equity ratio of 0.67. Whether this ratio is low, moderate, or high depends on the ratios of other vintage toy stores.

CASH FLOW PROJECTIONS

A significant percentage of small businesses struggle and/or fail due to their inability to adequately manage their cash flows. A business cannot operate very long when cash outflow exceeds cash inflow. Every small business must monitor its cash flows to prevent a serious business disruption.

Many businesses' cash flow issues stem from an absence of cash flow projections that adequately address day-to-day activities. Businesses that do not take the time to thoughtfully estimate their cash flows over the coming period (day, week, month, quarter, etc.) place themselves at serious risk.

For example, a poor or nonexistent cash flow projection can create significant problems if the business has not addressed how it will manage its cash in between the time that it must pay vendors, employees, and others, and the time that it collects from its customers. A business' cash management is extremely important to ensure that the business has the liquidity to adequately support day-to-day operations. Strong cash flow management can mean the difference between being in and out of business.

When applying for a loan the small business must be able to demonstrate that it can meet all of its liabilities as they come due. Chi Ishobak does require that borrowers have the ability to repay their obligations and proposed obligations through cash generated from operations. The loan committee will evaluate the cash flow from the business, the timing of payments, and the probability of successful repayment of the loan before making a credit decision.

Principals must ensure that adequate time and effort has been invested to prepare a reliable cash flow projection. This is especially important when the projections are for a new business or an expanding business with anticipated revenues and expenses exceeding past performance by a significant amount.

In addition to demonstrating the ability to meet future obligations through a cash flow projection the principals and the business must also demonstrate their willingness to make payments by keeping a credit history that shows timely payment of outstanding debt. Payment history on existing debt is considered an indicator of future payment performance. As such, small business owners must pay all of their bills and other debts on time to demonstrate that the small business and its owners can be relied upon to repay a loan. The loan committee will also want to know whether the business has any contingent sources of repayment in case cash falls short of projections.

Sample Cash Flow Projection

Cash In	Month 1	Month 2	Month 3	Month 4
Starting Cash	$0	$4,240	$5,980	$7,720
Equity Investment	$10,000			
Sales	$5,000	$7,500	$7,500	$7,500
TOTAL CASH IN	$15,000	$11,740	$13,480	$15,220
Cash Out				
Start-up Expence	$5,000	$0	$0	$0
Rent	$1,000	$1,000	$1,000	$1,000
Salaries	$4,000	$4,000	$4,000	$4,000
Utilities	$200	$200	$200	$200
Postage	$60	$60	$60	$60
Taxes	$300	$300	$300	$300
Advertising	$200	$200	$200	$200
TOTAL CASH OUT	$10,760	$5,760	$5,760	$5,760
ENDING CASH	**$4,240**	**$5,980**	**$7,720**	**$9,460**

WORKING CAPITAL

Working capital is defined as the difference between current assets and current liabilities. Current assets are the most liquid assets on a business' balance sheet. They are cash or can be converted quickly to cash. Current liabilities are any obligations due within one year. Working capital measures what remains once current liabilities are subtracted from current assets. Working capital can be a positive or negative amount. Working capital is available to pay the business' current debts, and represents a cushion or margin of protection.

Positive working capital is essential for a small business to meet its continuous operational needs. The availability of working capital influences the business' ability to meet its trade and short-term debt obligations, as well as to remain financially viable. If the small business' current assets do not exceed its current liabilities, the business runs the risk of being unable to pay short term creditors in a timely manner.

Businesses that are seasonal or cyclical often require more working capital to stay afloat during the slow period. Although a small business may make during the year more than enough to pay all of its obligations, it must ensure that it has enough working capital throughout the year to meet its short term obligations. For example, a company may make the majority of its sales over the holidays, resulting in large payoffs at the end of the year. However, the company must have enough working capital during the entire year to buy inventory and cover payroll when revenues and cash flows are lower.

Sample Working Capital

Cash	$90,000
Accounts Receivable	$10,000
Inventory	$30,000
Total Current Assets	$130,000
Accounts Payable	$45,000
Other Current Liabilities	$12,000
Total Current Liabilities	$67,000
Working Capital	**$63,000**

COLLATERAL

Collateral is a form of security that can be used to assure the lender that the small business has a secondary source of loan repayment if the primary source (cash flow from operations) fails. Assets such as equipment, buildings, accounts receivable, and inventory are considered possible sources of repayment if they can be sold by the lender to settle the outstanding debt. Collateral can consist of assets that are usable in the business as well as personal assets that remain outside of the business.

Small businesses applying for a loan should assume that all assets financed with borrowed funds will be used as collateral for the loan. Depending on how much equity was contributed by the principals toward the acquisition of these assets, the lender may require other assets as collateral.

Chi Ishobak is required to obtain a third-party valuation when commercial real estate is being purchased with loan funds and used as collateral. Chi Ishobak may also require professional appraisals of business and personal assets, plus any necessary survey and/or environmental report to substantiate the integrity of the collateral.

To the extent that worthwhile assets are available, adequate collateral is required as security on all Chi Ishobak loans. In addition to collateral, Chi Ishobak requires personal guarantees from the principals. A personal guarantee is an agreement saying that you will be personally responsible for repayment. Even if the business is incorporated to limit personal liability, you are personally tied to any loan you've made a personal guarantee on.

An Abundance of Collateral

Mary obtained a $100,000 small business loan to purchase equipment. In order protect itself from a loss the lender used the equipment as collateral by placing a lien against the equipment. In the event that Mary's business failed to produce the income projected and failed to make payments on the loan, the lender would sell the equipment but likely recover only a portion of the loan balance from the sale of the equipment, leaving the lender exposed. To provide further protection against a loss the lender supplemented the security on the loan by placing a lien against all of Mary's business assets. With more equipment as collateral the lender can more easily prevent a loss if the cash generated from the sale of the original equipment does not cover the balance owed on the loan.

BUSINESS ADMINISTRATION

Business administration is the process of managing the day-to-day affairs of the business. This includes how the principals pay the bills, collect on the debt owed, deliver the products and services, and manage the inventory.

A small business' demonstrated ability to manage its day-to-day affairs is a prime consideration when making a loan decision. There are also some areas in which the small business needs to appear strong in order to make a favorable impression.

- Character: The impression made by the principals is very important. The loan committee makes an assessment as to whether or not the principals are sufficiently trustworthy to repay the loan. Character is determined by a number of factors, including but not limited to, prior loan history and reputation in the industry.

- Managerial Capacity: The principals' educational background and experience in business as well as past achievements in their industry determines managerial capacity. The quality of the principals' references and the background and experience of company employees are also important.

Historical and projected financial statements can be used to create metrics that provide insight into how the business has been managed in the past and how it will operate in the future. No single metric tells the entire story, but the use of several metrics in conjunction with one another can give an overall picture of management's performance.

Some key metrics that the loan committee will review include:

- Debt-to-equity;
- Working capital;
- The rate at which income is received after it is earned;
- The rate at which debt is paid after becoming due; and,
- The rate at which the product or service moves from the business to the customer.

Industry advocacy organizations often maintain metrics. Each industry is unique and ratios may vary from industry to industry, as well as, based on a small business' characteristics (e.g., revenues, years in business, franchise/non-franchise, etc.). Tribal entrepreneurs and small business owners should be aware of their key metrics relative to their industry prior to applying for credit in order to fully understand the impact that the borrowing will have on the business and to understand the information being considered by the loan committee.

HOW MUCH TO BORROW?

Before applying for a loan the principals should thoroughly assess the business' current financial situation. The Small Business Administration encourages small business owners to answer the following questions to better understand the business' financing needs:

- Does the business need more capital or can it manage with the existing cash flow? A business that is having trouble paying its obligations on time may need an infusion of working capital to relieve periods of weak cash flow.
- What is the nature of the small business' need?
- Does the business need money to start or expand its business or as a cushion against risk?
- How urgent is the need for more capital? It's better to anticipate the business' capital needs rather than seeking capital under pressure. It is harder to gain approval for a loan when the small business is in trouble.
- How great are the business' risks? All businesses carry risk, and the degree of risk will affect both the cost of the loan and available financing alternatives.
- In what stage of development is the business? Needs are generally more critical during transitional stages - start-up and expansion being two of the most urgent and costly.
- How will the capital be used? The loan committee will need to know the specific intent for the money.
- What is the state of the business' industry? Is the industry depressed, stable, or quickly-growing?
- Is the business seasonal or cyclical? Seasonal cycles require funding that is generally short term, and consists of smaller loans with a shorter maturity. Loans for cyclical industries, such as construction, are designed to support a business through depressed periods - these industries are sometimes known as 'feast and famine' businesses as the cash flow is often erratic and unpredictable.
- How strong is the business' management team? Effective management is an important element of business. The loan committee will look for a strong managerial presence.
- Is the need for financing consistent with the business plan? Small business owners must make the completion of a business plan a priority. All lenders will want to see a solid, well thought out business plan for the start-up and growth of a small business.

These questions assist the loan committee in determining how to best structure the financing so that it meets the needs of the Tribal entrepreneur or small business. For example, financing can be long-term if used to purchase a building, or short term if used to finance seasonal working capital. The better the information, the better the loan structure.

DOCUMENTATION CHECKLIST

Chi Ishobak will need many documents to prepare your loan package for the loan committee. Although that may include more than this list, the following are items that will generally be required as part of any small business loan application:

Personal Background: Either as part of the loan application or as a separate document, this information will be requested, including previous addresses, names used, criminal record, education, etc.;

Resume: Some lenders require evidence of management or business experience, particularly for loans that are intended to be used to start a new business;

Business Plan: Lenders generally require the submission of a thoughtful business plan. The business plan should include a complete set of projected financial statements, including profit and loss, cash flow, and a balance sheet;

Personal Credit Report: Chi Ishobak will obtain a personal credit report for each principal as part of the application process. Each principal should obtain a credit report from all three major consumer credit rating agencies prior to submitting a loan application. This can be done for free at AnnualCreditReport.com. Inaccuracies and blemishes on a credit report can delay or negatively impact the loan application. Advance notice of any credit issues can assist the principals in addressing these items before beginning the application process;

Business Credit Report: The lender will usually obtain a business credit report. It is important for the principals to review in advance the business' credit report in order to identify and remedy any issues;

Income Tax Returns: Chi Ishobak requires applicants to submit personal and business income tax returns for the previous 3 years;

Financial Statements: Chi Ishobak requires principals to submit signed personal financial statements from all principals holding at least 20% ownership. The principals may also be required to provide projected financial statements, either as part of, or separate from, the business plan;

Bank Statements: Chi Ishobak may require personal and business bank statements to be submitted as part of a loan package;

Collateral: Collateral requirements can vary. Loans involving higher risk require substantial collateral. While strong business plans and financial statements can lower collateral requirements, Chi Ishobak requires some form of collateral on all loans to protect against risk. Principals should prepare a collateral document that describes the cost/value of personal and business property that can be used to secure a loan; and,

Legal Documents: The lender may require the principals to submit one or more legal documents. The following documents are typically requested:

- Business licenses and registrations required to conduct business;
- Articles of Incorporation;
- Copies of contracts with any third parties;
- Franchise agreements; and,
- Commercial leases

Tribal entrepreneurs and small business owners - particularly those of start-ups - are advised to seek legal counsel relative to formation documents and filings, leases, purchase/franchise agreements, employment contracts, and other documents that benefit from having a legal review.

In addition to legal counsel, small business owners should also seek assistance from local organizations such as the Small Business Development Center (www.sba.gov/tools/local-assistance/sbdc) or SCORE (www.score.org). Both organizations provide support to small businesses, including the provision of fee-free consulting services.

Chi Ishobak has developed technical assistance programs for both the aspiring entrepreneur as well as the established business. For aspiring entrepreneurs, Chi Ishobak helps clients evaluate business ideas and establish a plan to turn those ideas into reality. Once your business is operating, new opportunities for growth and development will arise. Training and one-on-one assistance can help make your small business grow more efficient, more productive, and more profitable. Either through one-on-one consultation, mentoring, or workshop instruction Chi Ishobak provides assistance with most key business topics.

SMALL BUSINESS RESOURCES

Small Business Development Center – Michigan - www.SBDCMichigan.org

S.C.O.R.E. - www.SCORE.org

Cornerstone Alliance – www.CstoneAlliance.org

Small Business Administration – www.SBA.gov

Business Plan Help Online – www.BPlans.com

Investopedia – www.Investopedia.com

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