

A Guide for Franchising Financing

Q: I've found the franchise I want, but I don't have enough cash to completely fund the startup of the business, so I'm going to need to get a loan. I'm just starting to talk to banks, and they seem to want a number of things I don't have, such as a complete business plan with projections for the business. They also expect me to personally guarantee the loan even though the business is a corporation. Is my best option to use the SBA in order to avoid these hassles, or what should I do?

A: This is the number-one topic for questions we receive. The best source of information about your financing options is the franchisor. They should be able to tell you, from experience, how likely it is for you to obtain financing from any particular source.

It may also be helpful to understand the principles that underlie your ability to get financing, regardless of the lending source. There are "Cs" involved in any decision to loan money to someone: Cash, Credit, Collateral and Character.

The fact is that it doesn't matter whether you go to a bank, use the SBA guarantee service or go to a friend or relative for the loan. The same basic rules apply to any successful attempt to get credit. Here's how the four Cs work:

Cash

One of the most common misconceptions people have is that they can borrow all the money they need to open a business. Unless your personal net worth is far larger than what you need to borrow, this is almost certainly not true. You'll have to come up with cash out of your own assets, probably equal to at least 25 to 30 percent of the total investment needed to start the business. Lenders like to make sure you personally have "skin in the game."

Credit

Another thing lenders insist on is a strong credit history. This means they want to see a track record of you borrowing money and making your payments on time. Though your home mortgage might be the best example of a large loan you have serviced well, you'll find you get almost no credit for that type of loan. Everyone realizes most people will take care of their mortgage before their other bills, so what they really want to see is a pattern involving timely payments on other types of loans. While a good credit history doesn't mean you'll get a loan, a bad one almost guarantees that you won't.

Courtesy of CFO Capital Partners.com

Collateral

Most lenders require you to completely secure any loan you want with personal assets sufficient to provide for 100 percent recovery if you default on the loan. It doesn't matter one bit whether your business is a corporation or any other type of entity, or whether you go through the SBA process—they are going to look to you for collateral.

Character

The final condition you must meet relates to your character or reputation. Frankly, this is like your credit history—having great character won't ensure you'll receive a loan, but having a bad reputation will almost guarantee that you won't. Having strong enough character and a great reputation used to be enough to offset a lack in some of the other Cs, but those days went out the window with the S&L crisis 15 years ago, at least as far as any regulated lender is concerned.

You also mentioned a lender's request for a complete business plan. You should have a complete business plan before embarking on any new business startup for a host of other reasons besides just financing. If you don't have one, stop everything else and put it together. The franchisor you're working with should have a lot of helpful information or even a template already developed for this purpose.

Many franchisors have also set up programs with selected financial sources to facilitate rapid funding of their franchisees. In this case, they should be able to walk you through the process with a minimum of hassle for you. The first thing you should do, once you're fairly certain you've found the franchise you want to buy, is to request this information from the franchisor and start looking into your options.