Borrowing for small businesses

A guide to smart financing for your business

TRUIST

Get the funds you need.

Understanding financing options and the borrowing process puts owners in the best position to get the funding they need.

As a small business owner, you want to see your business thrive while you excel at serving your customers, and when it comes to funding, you want to make sure the borrowing process doesn't distract you from those goals. Learning why businesses borrow, where to turn for funding, and how the lending process works makes for a smoother, smarter, and often more successful outcome.

As you explore financing, you'll want to answer these questions:

- Should I seek funds?
- What's the best financing for my business?
- How can I prepare my business to borrow?

A good financing outcome starts with the confidence that securing funds is the right path to achieve the business results you want. The best source of funds will depend on many factors, like your development stage, amount of equity invested, profits accumulated, and funding needed. And your preparation for the lending process will often determine your success in securing financing.

This guidebook will help you learn:

1. Why businesses need funds
2. Where to find funding
3. How to select the right type of financing
4. What lenders look for
5. The borrowing process
6. How to create your business borrowing profile
7. Next steps after a financing decision

Use the Owner's notes to summarize important points and prepare for your next steps in financing. To start off: When you started your business, what were you most passionate about?

1. Why businesses need funds

Businesses need funds to drive meaningful outcomes. The need may be an investment in inventory, a new piece of equipment, supplies for a new job, or a gap in the everyday cash flow that can occur in running a business.

Businesses can cover cash needs by making a profit—bringing in more cash than it costs to run your business. But profits alone may not provide sufficient funds to cover the need. It can take time to accumulate enough profits to cover the onetime costs of a new piece of equipment, the outfitting of a new location, or a marketing and advertising campaign.

Financing starts when you identify a business outcome that needs funding. Review the business outcomes below, along with the examples of how funding could be put to use.

Business outcome	Action examples
Grow business – drive sales	• Open a new location • Launch a new product • Increase digital marketing
Increase production or service capabilities	• Automate/add equipment • Upgrade software/technology • Train additional staff • Replace a worn-out delivery van
Boost profits	• Shift sales from in person to ecommerce • Take advantage of volume purchase discounts to lower costs • Increase staff productivity
Manage cash engaged in the business	• Consolidate debt • Build inventory for busy seasons • Handle seasonal cash requirements • Secure funds for one-time/unplanned expenses

When is debt financing not ideal?

There's too much existing debt
Adding more payments than you can afford can cripple the business.

The business is not profitable
Without profits, your business can't repay a loan.

Funding won't be used for a sound business purpose
Paying back unproductive debt can starve your business of funds needed for more promising opportunities.

Owner's notes | What are the business outcomes I am seeking and the actions I can take to reach them? Do I already have funding for those actions?

Business outcome	Actions my business could take	Fund with existing cash?
Grow business – drive sales		☐ yes ☐ no
Increase production or service capabilities		☐ yes ☐ no
Boost profits		☐ yes ☐ no
Manage cash engaged in the business		☐ yes ☐ no
Other		☐ yes ☐ no

2. **Where to find funding**

If your business needs funds to realize its outcomes, there are several places to find them. While some businesses may have accumulated profits as cash reserves to access when necessary, many will turn to outside sources to find the funds to grow sales, increase production, or boost profits.

Sources of funds	Pros	Cons
Business cash reserves	• Inexpensive, low risk source of funds • Flexibility to use profits and retain control of the business	• Accumulating reserves can take time • Limits cash availability for emergencies or other needs
Equity investment by owner	• Primary source for startup/early-stage businesses • Quick access to funds	• Requires additional cash from owner personal funds • May create personal financial stress
Equity investment from external source	• No repayment schedule • Potential industry experience and connections from investors	• Owners may give up control and future profits • Investors expect a higher return
Borrowing	• Often lowest cost form of outside financing • Owners retain control, equity, and profits	• May not be available for new business or those without sufficient equity • Business/personal assets at risk if not repaid

Business cash reserves offer a low-cost source of funding. But there aren't a lot of small businesses that have enough funds saved up, particularly since businesses usually consume cash as they grow to fund working capital, like accounts receivable and inventory. And you don't want to consume all your spare cash that you may need to cover unexpected expenses or take advantage of opportunities that arise.

Equity may be best, particularly for startups and companies without much equity built up. Avoid concentrating too many personal assets, like your personal savings, into your business, especially if your business is also your primary source of income. Outside investors are an option, but be mindful of giving away precious equity and adding business investors that could be around for a long time.

Borrowing can be an attractive option when you need to find the cash for a large purchase—real estate, equipment, or vehicles—and want to spread costs out over time. Banks, government agencies, and other lenders will often lend funds to profitable businesses that can provide assets for collateral and can repay the loan.

Borrowing is often the least costly outside funding option, but it is also the least flexible—loans require regular payments, and a missed payment could put the loan into default and the business in jeopardy.

Owner's notes | Business cash reserves vs. equity vs. borrowing – Which is best for your business?

How much do you have in business cash reserves? $____________________

What plans do you have to use them? ____________________

Do your profits support reinvestment in the business? ☐ yes ☐ no   Does your cash flow meet your needs? ☐ yes ☐ no

What plans have you made to secure more equity? ____________________

Who will provide it (e.g., owner, investor, etc.)? ____________________

How much debt do you have now? $____________________   Do you have plans to borrow more? ☐ yes ☐ no

3. **How to select the right type of financing**

There are a wide variety of financing solutions that fit different business needs and growth stages. From business credit cards (best for everyday purchases) to lines of credit (best for recurring or seasonal cash flow needs), businesses have many options, and an experienced lender can help you find the right solution.

If you decide to borrow, expect that each month you'll need to pay interest and usually some portion of the outstanding loan balance. Some types of financing, especially larger requests, require collateral to be pledged as security for repayment. Lenders usually require owners to provide a personal guarantee as well.

Understanding types of financing

	Business credit card	Business loan	Business line of credit
Best for	Everyday purchases, rewards based on spending, or very short term borrowing	Financing major purchases or one-time cash needs	Recurring or seasonal cash flow needs
How you access funds	Available up to a limit and tied to a card for purchases; may be able to transfer balances for a fee	Typically, funds at one time after your loan closing	Available to draw up to your line limit; how you access will depend on your lender.
How do payments work	Pay a minimum amount monthly and incur interest charges, or pay entire balance to avoid interest.	Balance reduces over time as payments are tied to loan maturity or amortization term.	Lenders may offer interest only payments or a percent of the balance plus interest.
Interest rates	Interest typically variable (floats) and often higher than bank loans	Typically, fixed rates locked in when you close your loan	Interest typically variable (floats)
Collateral	Typically, unsecured	Can be secured or unsecured. Larger loan sizes may require collateral.	Can be secured or unsecured. Larger loan sizes may require collateral.
Check	☐ Have ☐ Need	☐ Have ☐ Need	☐ Have ☐ Need

When borrowing, remember that debt that adds value to the business should be repaid over the life of the asset it's used to finance. If the debt doesn't add value, repay it as quickly as possible.

Other financing types

Business lease – allows the business to use the property owned by the lessor. May have an option for the user to purchase the property. Often used for commercial real estate, office equipment, and business vehicles.

Construction loan – a type of real estate loan where the balance increases as a project is completed until a point where the loan is paid off or converted into a commercial mortgage.

Small Business Administration (SBA) guaranteed loan – a type of financing offered by lenders where the SBA guarantees a portion of the loan. Often a way for borrowers to obtain longer terms or flexible funding if they do not meet conventional borrower qualifications.

Other funding sources

Though some businesses may borrow startup capital, most are financed initially by their owners or close family. Many lenders require some amount of time in business—often two years—and those businesses that do borrow early often start with credit cards before other financing. As a result, new businesses sometimes look for other sources of funding outside of owner equity, bank loans, or credit cards.

Description	Considerations
Family and friends	• Can be easier to obtain than other alternatives • May offer lower interest rate and more flexible repayment terms • Can add strain to family and friend relationships
Equity investors (angel investors, venture capitalists, outside investors)	• Provide funds in exchange for ownership share in the business • Typically, no payments— investors are seeking a share of the profits and proceeds from any ownership sale • Some investors are experienced business owners who can provide practical advice and may want input into business decisions • Finding the right investor can be a long, involved process
CDFI (Community Development Financial Institutions)	• Typically serve community businesses—small businesses, microenterprises, nonprofit organizations, commercial real estate, and affordable housing • Financing for businesses that spark job growth and employee retention in hard-to-serve markets • Tailored for smaller and early-stage businesses
Online lenders	• Fast decisions on loans and quick funding (sometimes within days) • Predictable monthly payments • More lenient on credit criteria with less documentation required • Typically, higher interest rates • May be difficult to find for large loan amounts
Peer-to-peer (P2P) lending sites (e.g., Funding Circle, CircleUp)	• Borrowers with lower credit ratings may qualify • May offer lower interest rates than other options • Fast application processing • No interaction between lender and borrower • Mostly used for personal loans, but growing use for small business loans • May require substantial personal information to determine loan eligibility
Crowdfunding (e.g., Kickstarter, Fundable)	• Works best for funding new products • Requires an excellent marketing campaign and social media savvy • A strong social media following helps secure funding • Minimal cost to try (but considerable time investment)

Owner's notes | What funding sources or lending products do you think your business may need in the future?

4. What lenders look for

If your business can benefit from financing, you want to have the best chance of getting the funds you need. That means being armed with a strong business case and all the necessary information and documentation.

A lender needs to ask a few basic questions to understand your request and evaluate your ability to pay the loan in full. The lender may look at your business and personal credit history, financial records, how you'll use the funds, repayment expectations, and ability to provide security in the form of collateral.

If you want to make the strongest case for financing your business, understand the five C's of credit—credit history, capacity, capital, conditions, and collateral—and address them in your discussions and written application materials.

	What lenders want to see	How it's evaluated	What you can do about it
Credit history	Do you pay what you owe on a timely basis?	• Business credit history • Personal credit history	☐ Check your credit rating regularly and devise a plan to constantly improve it. ☐ Pay your bills and make debt payments on time and in full.
Capacity	Are your current sales enough to support paying off a loan?	• Sales, expenses, profits • Tax returns/financial statements • Checking account history	☐ Run a profitable business and understand your finances.
Capital	Do you have enough equity or down payment for your business?	• Business liquidity (checking, savings) • Personal liquidity • Equity in other property • Business/personal net worth	☐ Plan to invest part of the total cost as a down payment, often 20%. ☐ Pay off your debts as expected.
Conditions	How will you use this loan considering your business's risks, the industry environment, and current macroeconomic conditions?	• Loan purpose • Business financial condition • Industry and economic outlook	☐ Have a clear business need that leads to an economically positive outcome. ☐ Create a backup plan to cover risks.
Collateral	Do you have collateral that you can provide as security against your loan?	• Assets purchased or refinanced to use as collateral • Other business or personal assets, net of existing loans • Business/personal credit history	☐ Collateral is usually required on larger loans. More collateral can improve your loan terms.

Owner's notes | Check the items above that you can affect in the "What you can do about it" column to position yourself best.

5. **The borrowing process**

The process of borrowing funds for your business typically follows seven steps. Understanding those steps can help you get from needing a loan to receiving funds and on to repaying them successfully, as simply as possible. Below, review the steps common to lending processes at most banks, financial institutions, or online lenders.

	Borrower's responsibility	Lender's responsibility
Identification - deciding you need a loan	Understand how the financing is used & will be repaid	Understand how the financing is used & will be repaid
Application - an official request for credit	Provide required information & documentation; certify existence & authorization	Assist the applicant through the process & answer all questions
Underwriting - making a credit decision	Answer any additional questions or provide documentation	Apply credit policies consistently without regard to legally prohibited characteristics (race, gender, religion, etc.)
Decision - approve or decline	Accept or reject the proposal	Communicate the decision & terms clearly & promptly
Processing - appraisals and final requirements	Provide additional information as requested	Complete all requirements for collateral, documentation, & funding; unsecured loans can be quick, while real estate loans usually take longer
Closing - signing and funding	Review & acknowledge all contractual agreements	Explain documentation to complete & fund the loan
Repayment	Make payments on time, & notify lender of any changes in your business	Provide updates on repayment balance & of any important account information

The borrowing process can take anywhere from a day to several weeks depending on the size and type of your loan and collateral provided.

6. **How to create your business borrowing profile**

A business borrowing profile is a snapshot of your business and your funding needs. Completing the profile ensures you have a clear understanding of your business situation, reasons for borrowing, and plans for repayment. While most lenders will not ask for this level of detail as part of a loan application, preparing the profile will help you articulate your request clearly.

This business borrowing profile is for your informational purposes only, and the information will neither be uploaded to an application, nor will it be considered an application for credit.

Business background and owner experience

Name of business: ______________________________

Owner's name(s): ______________________________

Years in industry: ______________________________

What we do/industry served: ______________________________

Top three products/services: 1. ______________________________

2. ______________________________

3. ______________________________

Customers we sell to: ______________________________

Sales over the past two years: Last year $______________ Previous year $______________

Profits over the past two years: Last year $______________ Previous year $______________

The driving factors behind sales and profits increases/decreases has been: ______________________________

____

In the past year, customers are paying: ☐ Faster ☐ Slower ☐ About the same

Is the business seasonal? Describe: ______________________________

Owner credit experience: (list and explain any prior negative credit experience: bankruptcy, foreclosures, collections, unpaid bills, late payment history) on either business or personal credit history.

____

Your loan request

Use this section to document the amount and purpose of the loan, the expected business results, and the repayment plan.

Amount of loan requested: $______________

How will you use the funds: ______________________________

____

Business outcome

Business growth – drive sales. Describe how: ____

____

Increase production or service capabilities. Describe how: ____

____

Boost profits. Describe how: ____

____

Manage cash engaged in the business. Describe how: ____

____

Loan repayment

I expect that (☐ new profits ☐ existing profits – check one) will pay off the debt.

Collateral offered is: $____________________________

Amount of down payment is: $____________________________

Desired monthly payment amount: No more than $____________ or ☐ minimum required

I'd like to finance the payments over ______ years or ☐ as long as possible

Application checklist

Almost all lenders require borrowers to provide information and documentation as part of the application process. You can increase the likelihood of being approved for funding by gathering the necessary information and documentation prior to applying for credit. Not all lenders and loans will require all these items, but if you have these ready, applying might be faster and easier.

Business Information

- ☐ Business name, physical/mailing addresses, and contact information
- ☐ Business established date
- ☐ Business industry description
- ☐ Tax identification number
- ☐ Business proof of ownership documents (business license, articles of inc., etc.)

Individual Information

- ☐ Individual identity verification (government issued photo ID)
- ☐ Individual and demographic information (name, physical address, identity information)

Lender specific Information

- ☐ Many lenders require a completed written or digital loan application request
- ☐ You may be asked to provide tax returns or financial statements for the business or individual owners
- ☐ Other information may be requested specific to the loan type you are requesting

7. **Next steps after a financing decision**

If you've just been notified that your funding request has been approved, congratulations! Be ready to execute loan agreements, and start getting your down payment funds together.

If your request is declined, you have the right to ask the lender for a written statement of the specific reason(s) for your denial if you ask within 60 days of being notified of the creditor's decision.

Four steps to prepare for your next financing

1. Build a record of making payments on time. Update your cash flow planning and monthly payment reminders to include loan payment(s) and other regular obligations or put all your payments on automatic draft.
2. Address any business issues or deficits that could keep you from securing credit.
3. Build your track record of sales and profit growth to support future borrowing.
4. Continue to build the equity value of your business—a strong balance sheet and capital structure position you for future financing.

Summary of key points

By understanding these points, you can put your small business in position to get the funds you need to sustain and grow your business

- Borrowing requests should drive meaningful business outcomes.
- Borrowing, along with equity and cash reserves, are the primary sources of business funding.
- The best type of financing for your business (credit card, loan, or line of credit) depends on your situation and what you want to accomplish.
- Lenders focus on five considerations when assessing a loan request: credit history, capacity, capital, conditions, and collateral.
- Understanding the borrowing process and setting the right expectations can lead to a smoother experience and a more positive outcome.
- Putting your borrowing profile in writing can help you and a lender understand the fundamentals of your business and your borrowing needs.

Owner's notes | **What are your key takeaways from this exercise?**

Glossary of small business financing terms[1]

Amortization: The allocation of payments to pay off a loan within the stated repayment period.

Appraisal: An estimate of the value of a property by a qualified professional appraiser.

APR: The annual percentage rate is the total cost of a loan. It includes the interest plus any other fees assessed.

Asset: All real or intellectual property owned by the enterprise that has a positive financial value.

Balance sheet: A summary statement of assets, liabilities, and owner's equity used to assess the financial condition of a business.

Borrower: A person or business receiving money from a bank or other lender with an agreement to repay the sum, plus interest, borrowed.

Budget: A detailed schedule of planned financial activity.

Capital: The wealth of a business based on money invested in the business, in the form of debt or equity, to generate income.

Cash conversion cycle: The time required to convert raw materials into finished goods, finished goods into sales, and sales into received payments from customers.

Cash flow: The amount of cash generated by a business after expenses are paid.

Cash reserves: Accumulated profits kept on hand to meet planned or unexpected cash needs.

Co-borrower: A person that signs the loan documents and has the same obligations as the borrower.

Collateral: Assets that can be pledged to secure a loan.

Cost of sales: The cost of goods sold plus expenses incurred in the selling and delivery of the product or service.

Credit limit: The maximum amount a debtor is authorized to borrow on a credit card or line of credit.

Credit report and credit score: For businesses, a number based on a business's credit and repayment history, legal filings, size, and length of time in business that determine a business's borrowing capacity and ability to repay. Personal creditworthiness is determined by a borrower's repayment history, number of open accounts, and total level of debt.

Debt consolidation: Combining multiple loans or debts into one account to reduce fees or to get a lower interest rate.

Debt financing: Paying for a capital investment with borrowed funds.

Default: Failure to make agreed-upon periodic payments on a loan.

Draw: Periodic funds used by the borrower up to the maximum amount of the loan, under a line of credit agreement with a lender.

Equity: The investment made by the owners or stockholders of a business.

Equity financing: Selling a piece of a business to an investor in exchange for capital.

Financial statements: The income statement, balance sheet, statement of cash flows and statement of shareholder's equity for a defined period.

Fixed assets: Non-liquid business assets used in the operation of a business.

Tangible fixed assets: Real estate, buildings, furniture, fixtures, and equipment

Intangible fixed assets: Trademarks, patents, and brand recognition

Fixed interest rate: A fixed interest rate holds steady throughout the term of the loan; it does not change with the market.

Floating interest rate: A floating interest rate, also known as a variable or adjustable rate, changes as market conditions change.

Guarantor: A person who agrees to assume the responsibility of assuring payment or fulfillment of another's debts or obligations.

Income statements: A statement of revenues and expenses, showing the financial progress of a company over a period of time. Also known as a profit and loss statement.

Interest rate: Represents the current rate of borrowing or the amount earned on an interest-bearing account.

Lease: A contract outlining the terms under which one party (lessee) agrees to rent an asset owned by another party (lessor).

Liability: A legal obligation to settle a debt.
- **Current:** Payable within one year
- **Long-term:** Payable one year or longer

Lien: The legal claim of a creditor to the pledged collateral of a debtor who does not meet the obligations of their contract.

Line of credit: A flexible loan consisting of a fixed sum of money that can be accessed as needed and repaid either immediately or over time.

Liquidity: A business's assets that can be quickly converted into cash.

Loan: A sum of money borrowed from a lender and paid off at specified intervals over a set period of time.

Loan down payment: Upfront payment required for closing a loan that reduces monthly payments required to pay off the loan.

Maturity: The date on which a debt becomes due for final payment.

Net profit: A positive net income after total expenses have been subtracted from total revenues. The opposite of net loss.

Net worth (equity; owner's equity): The amount by which assets exceed liabilities on the company balance sheet.

Payment: Sum of money due to the lender based on a predetermined formula.

Prepayment penalty: A fee that is assessed for paying a loan off early.

Principal: The original amount borrowed or the outstanding balance yet to be repaid, excluding interest.

Personal guarantee: An individual's (usually an owner's) legal promise to repay credit issued to a business.

Revolving: A loan, typically a line of credit, that allows a borrower to receive funds from a lender, repay them, and then repeat the process, as many times as needed, as long as the credit limit isn't exceeded.

SBA: The SBA, or Small Business Administration, is a government entity that helps small businesses secure financing by guaranteeing a portion of the loan to the lender against a loss.

Secured loan: A loan protected by an asset or collateral, to which the lender holds the title.

Tax lien: The legal claim of a government entity to seize or sell a taxpayer's assets when an individual or business fails to pay taxes.

Term loan: A term loan is a lump sum borrowed from a lender and paid off at specified intervals over a set period of time.

Unsecured loan: A loan or line of credit that does not require collateral, based on a borrower's creditworthiness.

Working capital: The cash available to a business for day-to-day operations.

[1] Adapted from Small Business Directory of Business Planning Terms, accessed August 2, 2021.

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