

# Using Debt to Finance Your Small Business

When your corporation takes out a loan, it is incurring debt. Loans are a well-known and well-used method of raising capital. The biggest drawback to taking out a loan for your corporation is that a loan must be repaid, both what you borrowed and the interest.

If you personally guarantee the loan, you will personally have to repay the loan if your company is unable to pay. The positive aspect of a loan is that lenders typically are only entitled to repayment, not an ownership in your corporation or a percentage of the corporation's profits.

## Lenders

Loans can be taken out from:

- banks or other commercial lenders
- individual lenders such as: shareholders, officers, directors, family or friends.

Bank loans may not be available for small, pure start-up companies due to unattractive repayment terms including the requirement that the borrower personally guarantee the loan. Because of this, it may be desirable to seek a loan for your corporation either from an individual lender such as those listed above, or from the U.S. Small Business Administration (SBA).

The current Small Business Administration was created by Congress in 1953, and provides information on starting, financing and managing smaller businesses. The SBA loans no money directly; instead, it guarantees a percent of individual loans made by private lenders up to a stated maximum.

The SBA works with banks, lending institutions and other investors. In order to qualify for an SBA loan, a business must demonstrate it cannot obtain conventional financing at reasonable terms. This business must also personally guarantee the SBA loan and show sufficient cash to repay the loan. An SBA loan guarantee can be very helpful in ultimately obtaining a bank loan for your business. A summary of SBA Loan Programs is available for preview and purchase at [www.AllBusiness.com](http://www.AllBusiness.com).

## Lender Questions and Document Requirements

Commercial lenders and banks customarily require answers to a series of questions regarding any corporation to whom they are considering making a loan. Documents supporting the answers are also required.

Lenders will typically ask the following questions:

- How much money do you want to borrow?
- How will you use the loan proceeds?
- How will you repay the loan?
- Does your corporation have the ability to make the payments required under the loan?
- Can you offer any collateral for the loan?
- Are you willing to put up a personal guarantee for the loan?

Lenders will likely request the following documents:

- A business plan
- Your corporation's incorporation or other documents
- Your company's tax returns for the last three years, or if your company has been in business only a short time, your tax returns for the same period of time
- Your profit and loss statements and balance sheets for the last three years, if any
- Your Board of Directors minutes or resolution approving the taking out of the loan
- A description of any litigation or bankruptcy proceeding involving your corporation
- A completed loan application.

### **Loan Arrangements**

Most loan arrangements involve a loan agreement and promissory note. Promissory notes are discussed below. Contrary to what you may be told there is no such thing as a standard loan agreement. You have the ability to negotiate virtually all terms in any loan you take out for your corporation, and you should take advantage of this. A "Checklist of Issues in Negotiating a Loan" is available for preview and purchase at [www.AllBusiness.com/forms](http://www.AllBusiness.com/forms).

Some basic loan issues include:

- Parties (including co-signors and guarantors)
- Interest
- Fees (including attorneys' fees)
- Payment terms (prepayment, grace period, late fees)

- Collateral
- Use of loan proceeds
- Representations and warranties of the borrower
- Affirmative covenants of the borrower
- Negative covenants
- Events of default
- Conditions to closing