Musbahu El Yakub

Business Borrowing

- Etiquettes, Principles and Processes

(A Guide For Start-Up Nigerian Entrepreneurs)

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By

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Caveat: As a Muslim, I do not encourage the reader to borrow unless they have 'compelling' reasons to. And if they do, they must take the responsibility seriously. This book is based on these presumptions.

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1.0 Business Borrowing

- An Introduction

Many people aspiring to go into business are unable to, on the 'grounds' that they don't have the required funding. This, I think, just shows lack of true desire, determination and commitment. As the popular saying goes, 'if there is the will, there will be the way'. Some of the most successful ventures in the world were started with virtually nothing. When Ross Perot left IBM as a salesman to start EDS in 1962, all he had was $4,000.00. It was so insufficient that they couldn't afford to fix a door to the office toilet. They made do with a flimsy curtain! Twenty-two years later in 1984, Ross Perot sold EDS to General Motors for $2.5 billion!

Sometimes, aspiring entrepreneurs want to start business awash in cash. Whilst this may eliminate the risk of running out of cash midstream, it is hardly a way to learn bootstrapping and efficient use of resources. In other cases, aspiring entrepreneurs do not explore the possibility of other funding options. For instance, may be you want to provide transportation service on a university campus with a fleet of tricycles ('keke NAPEP'). The institution has already granted you approval, but you lack the funds to procure the tricycles. Then, why don't you look at the option of taking an operating lease rather than borrowing to fund the purchase? This will eliminate the need for you to provide collateral, which you might not have, to the lender. Why don't you, also, consider a partnership with someone else that can bring in funds and possibly add non-financial value to the venture as well? The point is, there are several non-borrowing options of 'funding' your business. You just need to think deep and be creative.

Borrowing to fund business activities is almost as old as humanity. There have been major successes to individuals and corporations, as well as disasters arising from business borrowings. Large corporations and hitherto successful individuals have gone down under the weight of debt.

The capitalist system of the modern world is partly modeled on net borrowers taking money for investment from net savers. The altruistic objective is to create jobs and wealth by promoting industry and commerce. The system can only continue to survive and thrive if mutual contractual terms are respected and discharged.

There are different types of loans for different amounts, tenors and purposes. Institutional lenders use a set of criteria called the '5Cs' of credit to assess the quality of a loan application. These are 'capital', 'capacity', 'collateral', 'conditions' and 'character'. However, each loan request is treated on its own merit.

Business loans attract interest charges. These are rates normally expressed as a percentage of the loan amount. Depending on the type of business loan, interest charges can be fixed or variable costs to a business operation. Though interest rates might appear low, the quantum amount can be a significant burden on an organisation. To reduce the charges, a business must be efficient in its operations and aggressive in its collections. In addition to interest charges, lenders could also charge one-off or periodic 'arrangement/renewal fees', 'management fees' etc. Whatever the various charges might be, the borrower must understand the total costs of their borrowing.

Loan repayments should be taken seriously by every entrepreneur. The more you are able to discharge your debt obligations, the more you are able to establish your character as well as build your credit rating, thereby creating more opportunities to grow your businesses. Unless a business is viable and management is in control of its operations, unwise borrowing could easily kill it.

There can also be serious personal consequences to the entrepreneur on loan default. The first responsibility of any would be borrower is therefore to fully appreciate the moral, fiduciary and legal obligations and possible consequences of borrowing. The next challenge is for the aspiring entrepreneur to ensure that they are professional, diligent, and forthright in each and every borrowing step and action they take. Upon receipt of borrowed funds, the challenge becomes that of efficient and commercially-focused utilisation, and then the repayment to the lender as might have been agreed.

It takes effort, discipline and good judgment to convert business debt into profits and growth.

2.0 Business Borrowing
- Etiquettes, Principles and Obligations

"Don't ask to borrow unless you intend to repay them." – Mark Romagna

The major scriptures and cultures of the world all consider life and property as sacrosanct. Whenever you borrow money, you are taking someone's (an individual or institution) property on 'rent' and to be returned, usually at a cost for usage. Inefficient, poor or wrong use of borrowed funds can put not just you and your business, but also the actual owners at avoidable loss. At the extreme, loan defaults have caused global financial meltdown.

Borrowing has at least the following implications for you and your business:

•There is always a legal obligation to pay back,
•There is a moral obligation to discharge your commitments, and
•There is a fiduciary responsibility to exercise the highest standard of care in the use of the funds.

Success in the utilization and repayment of business loans emanates from two factors:

Commercial competence: Your ability to apply the borrowed funds into successful commercial use, from application to recovery. Unless, you can do this, there is absolutely no basis for you to borrow in the first instance.

Personal integrity: Your personal and corporate commitment and determination to repay the borrowed funds. If you are not sure of this, don't borrow either.

Whatever we are discussing in this book, presupposes the two factors above. Nonetheless, to help you sharpen these competencies in you, you should adopt a thorough and dispassionate approach to business borrowing by:

A) Start with the right mindset: Our minds have tremendous influence on us. Whatever we do or not is a reflection of what and how we think. Whenever we have the right mindset on any issue, we are likely to deal with it correctly. The psychologists tell us that how we think determines how we feel and how we feel determines how we act. It is therefore essential for the entrepreneur to start right at this level by having the right mindset on borrowing.

When an entrepreneur is planning to borrow, the first thing they need to have absolutely clear in their minds is that 'I must pay back'. Secondly, they should realise that the onus is on them to demonstrate the viability of the business. It is not for the lender 'to see' that. The integrity of their loan request presentation and the viability of the venture are what will determine that.

B) Consider the consequences of borrowing: Whilst you are more likely to focus on the possible financial benefits of business borrowing, you should also spend enough time checking the possible 'downside'. Businesses do run into problems. Sometimes our initial assumptions and judgments were simply wrong. Other times, our execution was poor. And for several other reasons in between the extremes, things do go wrong. Think of the entrepreneur with an excellent business proposition. She worked her projections which can even accommodate NGN320.00 to the US Dollar (when it was actually at NGN190.00). That would have been considered very reasonable and safe. Given the current economic situation however, the USD now exchanges for almost N500.00! Think of the implications. Yet, she has to handle it.

A borrower must be clear about what the likely negative consequences could be. Sometimes it could just be an 'easy' loss of a physical asset. Other times it could be your credibility at the stake. Whatever it could be, can you handle it?

Business borrowing is only for business purpose: Business debts should only be applied for business growth. Don't take a business loan and use it to live a personal 'good life'. It is both wrong and criminally fraudulent. If you have a personal need, borrow for that purpose and from the right institution. And if you do, you should structure its repayment separately and independently of your business obligations. Never mix the two, and do not let one undermine the repayment capacity of the other.

Be forthright: It is the information you provide to the lender that will form the basis of their taking decision, one way or the other. Information could be facts, opinions or assumptions. You must distinguish amongst them and state the assumptions you make clearly. Any deliberately misleading information, fraudulent misrepresentation, could lead to legal action taken against you in the event of default. You must communicate fully, honestly and on time with your prospective lender at all times.

Expect deal terms and documentation: Lenders won't just throw the money at you. There will be deal terms and documentations to cover them. In negotiating terms and conditions, you should only accept the terms that make sense and do not threaten the viability of your business. Usual terms will include specific purpose of the loan, how and when repayment(s) will be made, security offered, etc. Lenders also rely on the input documents you submit to them. The documents you submit must therefore withstand integrity tests. Documentations are important for all sides to eliminate ambiguities. They are evidences of sincerity and commitment of all sides.

Expect and allow monitoring: Lenders will generally require reasonable access to your premises and receipts of regular formal updates. It shall be a demonstration of your good intent to allow such access to your premises and submit updating documents to the lender. As mentioned earlier, the lender is usually a custodian of other people's money as well, and will report back to them regularly as to how all funds are doing. Allow them access and listen to their observations and suggestions. Where they do not understand the exigencies of your business, the responsibility is on you to explain.

Timing: Review and processing of loan applications by lenders usually takes time. As much as possible therefore, you should build in room for this when planning for your business borrowing.

Getting business loan requires your understanding of your business and knowing the rules.

Be ready for a 'no' (sorry, no's!): Quite frequently, the interests of the business are not always in congruence with those of the lender. This is because while the entrepreneur is willing to take business risks, the lender is willing to only take the finance risks. Even at that, the lender would take and put measures to mitigate against those risks. If the lender's conditions are not met, they are not likely to approve.

Sometimes, a rejection is not so much because your business or transaction is not viable, but because it does not fall within the captive areas the lender is expert or interested in, so called 'portfolio constraints'. (We will discuss how to avoid this later). Other times, a turndown by the lender is the right thing because you have failed to prove your case. In such eventualities, go back to the drawing board and consider the reasons for rejection. If they make sense, correct them and if not, look elsewhere for your funding.

In addition to the reasons stated above, lenders usually turn down requests for loan for one or more of the following reasons, which are actually just derivatives of the 5Cs, also mentioned earlier:

•Poor preparation,
•Poor cash flow,
•The exposure is neither secured by a collateral nor protected in structure,
•High and unmitigated risk,
•Regulatory constraints, etc.

'Nos' do one of three things to an aspiring entrepreneur. For the irresolute, they make them give up. For the resolute but unprepared, they make them work further and improve. For the resolute and prepared, they strengthen them. How you handle the 'nos' will reveal which group you belong to.

3.0 Funding Sources and Borrowing Processes

Funding Sources: As exemplified in the tricycle scenario earlier, you need to understand that there are several options of getting business services and products without having to borrow for them. These include:

•Getting investors for your business,
•Leasing or hiring assets instead of borrowing to buy,
•Contract manufacturing,
•Supplier credits,
•Extension of payables, etc.

The different options have different cash flow, legal, and tax implications. For each funding requirement, consider what alternative options may be available. For each possible alternative, assess the cost-benefit and make a decision as to which is optimum.

- Business borrowing process

Business borrowing from institutional investors has a process and you should understand it and how it works. Whether it is a start-up or an already running and successful business, you have to compile relevant details that will satisfy you as to, and demonstrate, the viability of business, as well as its capacity to repay the loan. This will usually be by way of a business plan, or at least a transaction detail. Unless you are satisfied with the business performance, no one else will be. This will form the 'backbone' of your loan application.

Needs assessments: The first thing you have to do is to make an assessment of your business needs and what the objectives are. Typically, the following are the kind of expenses and/or investments that an entrepreneur may be required to make:

•Need: Purchase of fixed assets (Objective: to increase production capacity arising from increasing demand),
•Need: Finance revolving working capital requirements (Objective: to meet increase in raw material requirements),
•Need: Finance one-off transactions (Objective: to meet an export order), etc.

The entrepreneur needs to ensure that they do a complete and thorough review of what they need. Sometimes, we over-estimate what we actually need whilst other times we under-estimate what we need. Both portend different dangers. With the former, we end up borrowing more than we actually need, with consequential increase in borrowing costs and risks of default. With the latter, we end up running out of cash before we complete the project at hand. Both, tendencies should be eliminated. The way to do this is by making sure you get good and current estimates from suppliers of goods and providers of services. Don't assume anything.

Other times, the 'needs' are just ego trips that do not add any value to the business. For instance, do you really need to buy a new 'official' vehicle for your use, when the one you have now is only two years old and in excellent working condition? Don't get caught up in these 'trips'.

- Documentation

Initial contact: Once you have established what your business needs are, the next thing is to identify possible sources of such loans. It is necessary to visit and discuss with at least a few institutions you believe can provide the loan. They usually have officers who will discuss 'generally' and give you an overview of whether or not they entertain such requests. If they do, they will also give you their 'usual' requirements, terms and conditions. This exercise will help you address their specific concerns while preparing your request. It will also eliminate the 'portfolio constraint' risk of turndown we mentioned earlier.

Business plan: As a businessman, you must have your very detailed business plan. When preparing a request for loan from an institution however, an abridged version, that provides all their required details may suffice. No matter, the following information must all be provided:

- What products or services are you offering?
- What markets are you planning to serve?
- What is your pricing strategy?
- Who is the competition and how do you plan to compete?
- What resources do you require to execute your strategy and how do you plan to acquire them if you don't already have them?
- If you will be borrowing, how much loan will you need? For what purpose(s)? How will you repay and over what period? Etc.

Getting a business loan requires further research into your business, planning, preparation and follow-ups.

The business plan will also include at least three very critical financial documents. These are:

•Proforma balance sheets, which show your assets and liability projections over the next years. (Where available, historicals should also be provided),

•Proforma income statements, or profit and loss accounts, which show your projected profitability over the next years. (Where available, historicals should also be provided),

•Cash flow statements, which shows your sources and uses of cash (both projections and historicals). The projections must show capacity to service and pay back the loan(s).

Depending on the specifics of your request, other financial details might also be required. You can produce these or work with your accountant or consultant to produce them. Whatever option you adopt, you should be fully involved. It is important you understand and accept as reasonable all assumptions that might be made.

The financial statements will reveal to you and your lender:

•Assets acquisitions and how they are or will be funded,
•Expenses incurred or to be incurred and how they were or will be paid for,
•All revenues and incomes and how they were or will be made,
•How your cash flow will service and pay back the loan to be taken. Etc.

In addition to the business plan, the loan request should include:

Loan amount required: This has already been established at the needs assessment level,

Purpose: Mention the specific and detailed purpose or purposes the loan amount(s) will be applied to. (In the event of approval, don't use funds for purposes other than what the lender agreed to. It is criminally wrong),

Tenor: Mention the period you will need the funds for. You should state if a moratorium on interest and/or principal payments is required. (As a rule, it is better to ask for a lengthy repayment period and perform, than a short period and fail),

Repayment source/ structure: Mention the source(s) of repayment, as well as how the repayment or repayments will be made and when,

Risk identification and mitigation: Identify what you consider are the business and finance risks and mention in detail what you will put or have already put in place as mitigants,

Scenario constructions: You should also be able to strengthen your request by looking at alternate (even if undesired) scenarios. You may, for instance, look at how increase in interest and exchange rates will affect your repayment ability, as well as how low demand for your products must go down before repayment capacity can be threatened.

Other issues that your request should seek to address include:

Security or 'how do you protect the lender?' Sometimes the loan structure is sufficient in protecting the lender, in which case collateral might not be required. Otherwise, you have to propose a security that covers them.

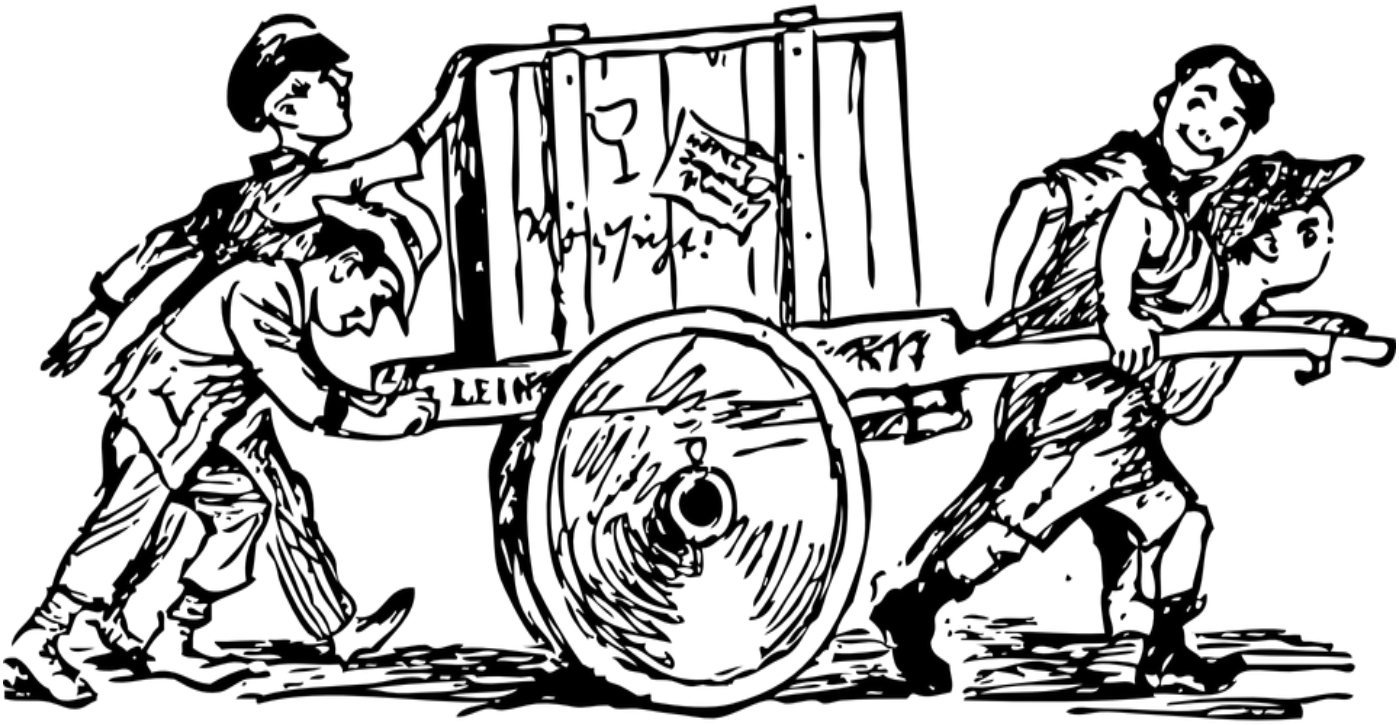
Other documentations: Other than the business plan and financials, you may also need to provide additional documentary details and evidences such as:

•Business registrations with Corporate Affairs Commission,
•Tax registrations and payments with Federal Inland Revenue Service,
•Title documents to specific assets that you will offer as collateral,
•Other specific approvals such as NCAA, FAAN, and IATA approvals if you are planning to start an airline or related business, etc.

Offer letter: At the end of the lender's review process, they will communicate their approval in an 'offer letter' to you. If you have engaged the lender actively in the course of their review, the offer letter should reflect your mutual understandings. You are to then review and accept it. However, if there are terms that you do not agree to, you can renegotiate. If any changes are agreed to, they should also be communicated in writing.

As soon as you meet all the 'conditions' in the offer letter, the lender will disburse the funds in line with your agreement. Note that, if after acceptance of your offer letter and disbursement, you need a change of any fundamental component of your offer (i.e. purpose, tenor, etc.), you must get the formal consent of your lender.

The hard work begins when you get the loan!



4.0 Business Gone Awry or - 'Handling Borrowing Challenges'

'It ain't as bad as you think' – General Colin Powell

Even the best business opportunities and executed by the most experienced and savvy entrepreneurs meet headwinds. Problems, challenges and setbacks in business are not unusual. The entrepreneur must just understand and learn how to handle them. The manner in which you attempt to handle problems will go along you in either creating more opportunities for you or closing doors on your face!

There are five principles of solving any loan problems:

•Study and understand the situation,
•Discuss extensively and widely and come up with solution(s),
•Communicate with your lender,
•Be forthright in all communications,
•Take prompt actions.

If the problem or challenge does not and will not affect your capacity to discharge your obligations to the lender, AND you can sort the problem on your own, then you can keep it to yourself and simply handle it. It is just one more thing in your day. In the event that your lender gets to know about it and tasks you on it, the explanation is a confident 'I could handle it and did not need to bother you. And I did'.

If however the problem may affect the business' capacity to meet up-coming maturing obligation(s), then you must discuss with your team and come up with possible measures to address the challenge. Upon that, you should discuss with your lender and put them in the full know. Give them the assurances they need to bless and accept your course of action. This can eliminate penalties that might have been inbuilt in your agreement in the event of default. (Penalties have a way of compounding your overall debt obligations, and must be avoided).

In the event that you will also need further support from the lender, you should let them know what assistance you specifically need and how that will help you sort out the issue. For instance you might need additional seasonal working capital support that arose because of increase in costs of input. As long as the increases will be profitably accommodated in increased pricing and sales, most reasonable lenders will extend further support.

There are also those times when you might need rescheduling of your repayment plan. Discuss with your lender before any default actually sets in, and explain what the cause is and how the rescheduling will eliminate the default risk. Lenders will rather reschedule than have you default on them, as long as they are assured you will meet the re-scheduling.

All the actions proposed above are only possible if you are on top of your game by:

Anticipating challenges: One of your key challenges as an entrepreneur is to be able to anticipate likely challenges and put in place measures to preempt or contain them. Sometimes, you need to alert the lender on what you are anticipating and the measures you have put in place. This re-assures them of your staying on top of situations, as well as build further trust.

(Not so surprisingly, one of the best ways to be able to detect up-coming challenges, is by being a participant in social-business circles! Discussions with others will reveal a few critical things that you might not realise on your own. Keep company of the good and the competent.)

Report challenges and seek support: The moment you identify an emerging challenge, or a challenge crops up, you should discuss with your people and come up with ways and measures to contain it. If you need external support, identify specifically what support you need and seek it from the right quarters.

A line of sincere communication is key to building and keeping trust in any lender-borrower situation. Difficulties should never take you away from this principle.

Take action: Taking appropriate and urgent action is the ultimate key to solving loan and indeed other business challenges. Procrastination is a luxury an entrepreneur can not afford.

Keep a level head: An entrepreneur needs a level head at all times. But at no time is this required as in difficult times. This means you must understand the situation as quickly as possible and take required actions without loosing faith and confidence in yourself. Realising your limitations as a human being and willingness to learn are key to this.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5.0 Conclusion

Business borrowing is a delicate issue that the entrepreneur must handle diligently and forthrightly. There are opportunities and challenges that may necessitate borrowing. Where such is the case, an entrepreneur must follow the borrowing process proficiently. It helps them understand their business further.

It also happens that businesses hit headwinds. In such situations, the entrepreneur must keep an open line of sincere communication with their lenders. Where specific assistance is required, the entrepreneur should seek it and demonstrate how that will help the situation. Understanding borrowing etiquettes will make life a lot easier for the entrepreneur even in the most difficult situations.

Successful business borrowing requires character and discipline, and the entrepreneur wishing to take on loans must fully appreciate both the upside as well as the possible downside.

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