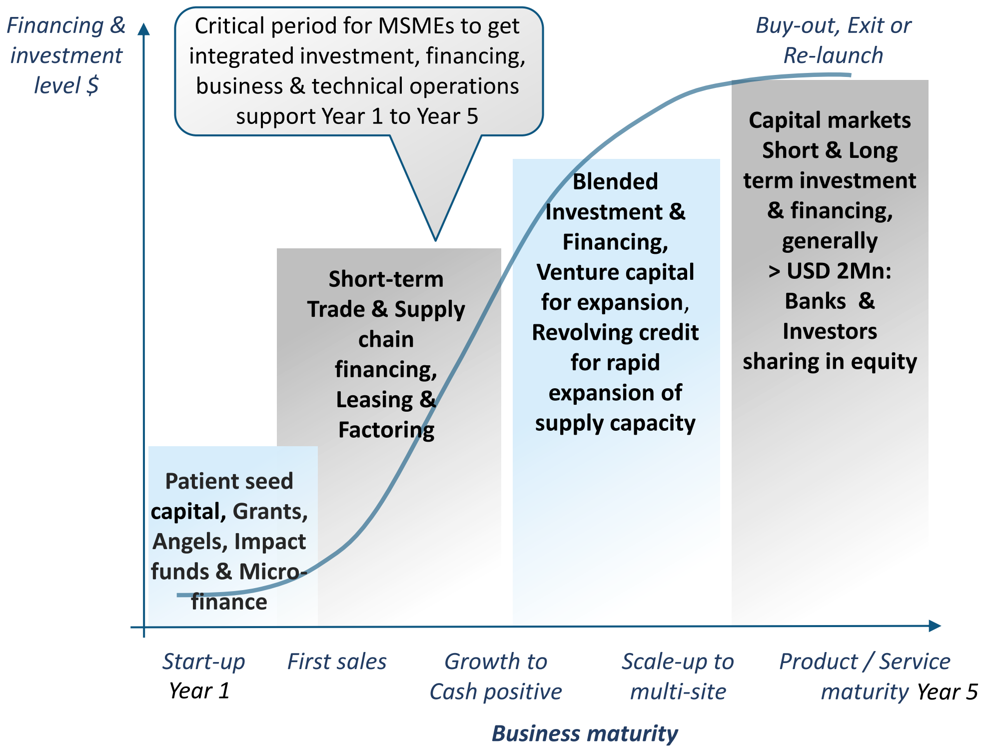
2. FINANCING OPTIONS & ELIGIBILITY REQUIREMENTS

This chapter highlights the financing options for MSME entrepreneurs, help them determine what kind of financing or investment they need, based on business needs and goals.

Before considering any type of financing, it is important to research what grant facilities are available for the type of business or sector. Interest-free grants may be provided by government agencies, buyers, NGOs, philanthropic foundations, or development projects such as UNCDF. The amounts may be small (usually up to US$ 5,000 per grant) and for use on specific purposes with tough reporting requirements. If the grant option fits, SMEs are advised to consider this option first.

Figure 1: Financing options related to business maturity and scale



Step 1: Establish what the money is needed for and how much you really need

This may sound simple, but entrepreneurs are often unable to identify clearly how much money is required, what it is need for and how it will benefit he business. For example, one may need some new equipment, like a roasting or drying machine, but fail to account for installation costs, transportation, materials wasted during

How much can you really afford to borrow and repay, and over what period?

testing when the equipment is first used.

Below is a set of questions that will help a business assess the right types of financing or investment to match business needs:

- **What is the financing needed for?**
  - Is it for working capital, to buy an asset with a lifespan of several years, for consumables or for a piece of equipment you will repay in less than one year (short-term finance)?

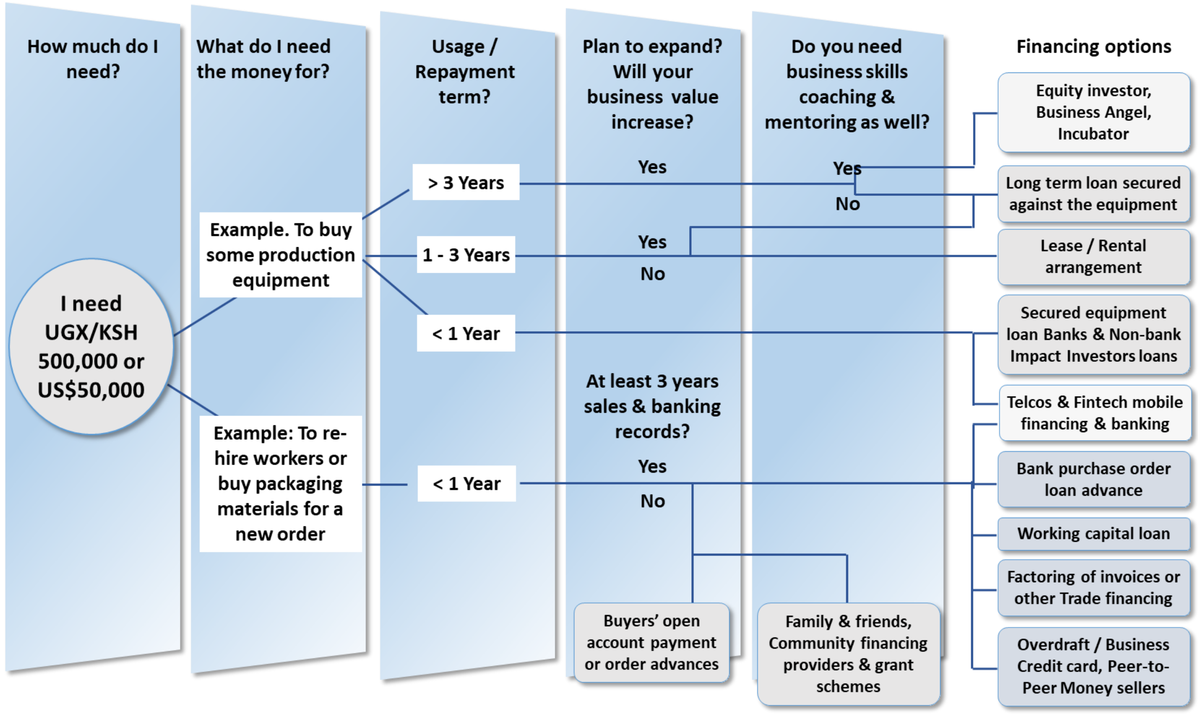
- **How much is needed and how soon?**
  - Determine how much your business needs, and how urgently. Make a list on a calendar
- **For how many months ahead are revenues assured?**
  - Show which revenues are seasonal, confirmed, invoiced, contracted and which are subject to delivery, sale to customers (consignment) contract renewal.
- **For how many years can you show records of consistent sales revenues?**
  - A bank would expect to see consistent transactions records for three years or more.
- **How much can your business afford and how quickly could you repay a loan?**
  - Calculate the disposable income of your business: Assemble records of all of your actual revenues and expenditures for the last three years. Show any seasonal differences. Include liabilities to keep your business going like leases, licenses, and marketing events.
  - Create a calendar and note on it when and how much revenues will be paid in, and when and how much payments must be made into the future. This is effectively your business “Cash Flow” plan. Include items like taxes based on previous year’s business, paying back interest and the principal of any loans or investors. Subtract total expenditures from total revenues, calculate one third of the balance, which will give an indication of the maximum amount of money the business can comfortably borrow. Look at the cash balances for each month and subtract the cost of the proposed loan repayments. If you are not breaking even each month you will be digging a cash hole in your business that will need to be filled from external sources.

You should also consider the following best practices:

- Any debt for more than one year above one third of your probable revenues incurs a risk to business continuity. The business could take a larger loan, but only if the risks are outweighed by the additional revenues such a loan would generate, and the certainty of realising them.
- Some loan and equipment lease contracts may contain *Covenants* – legally enforceable agreements that outline the nature of the financing transaction. If you already have equipment financing or loans for your business check the *Covenants* part of these contracts to understand the terms. For example you may find a covenant saying that the amount on your creditors’ ledger cannot exceed the amount on your debtors’ ledger for more than one quarter or you may receive an immediate recovery order by your lender.
- Note that this kind of “breach of contract” scenario happens to most businesses in their early years and is one of the most frequent reasons for business failures.

Take a look at the simplified financing decision-tree diagram in Figure 1, to identify your financing options or go to the *SME Access to Financing Quick reference Guide’s detailed Decision Tree* and explanations of different types of financing through this link *here* or in *Annex 1*, if you are reading this in the printed version.

Figure 2: A basic financing decision tree

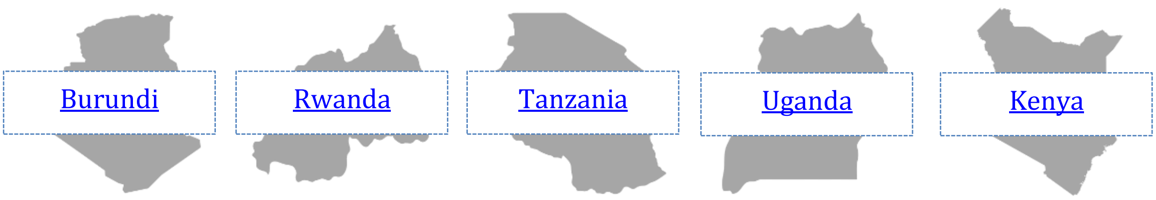


Step 2: Find out what business and personal information is required

Your application for financing or your pitch for investment will be judged almost entirely by the credibility, completeness and accuracy of the documentation that accompanies an application or business proposal. The top reason given by providers about why SMEs applications for financing are rejected so often is because of incomplete or inaccurate documentation or unrealistic predictions.

Step 3: Select two or three providers that could meet your needs

Providers of financing can be found in the MSME Financing Gateway for your country of interest. The Financing Gateway allows you to filter a dull directory of financing instruments and providers, match a selection to your needs and then link directly to their Internet pages or contact agents.



Which types financing could you qualify for?

Four main types of financing are available for MSMEs, each with different eligibility criteria, information, records requirements, and arrangement procedures.

Community financing providers – Range: US$ 5k to ~US$ 100k equivalent

This category includes credit unions (CUs), savings and credit cooperatives (SACCOs), cooperative banks, micro-financing institutions (MFIs), international non-governmental organisations (NGOs), diaspora funds, philanthropic organisations, telecommunications companies (Telcos), some large banks' women and young entrepreneur "start-up" promotion accounts and "pay-day lenders" or "pawn" brokers.

These sources are personal loans to an entrepreneur, normally providing short-term financing for working capital to start, improve or expand a business - repayable in less than one year. They apply high interest rates.

Below are examples of documentary requirements that financial providers will ask for:

- A completed signed application form
- Personal identity verification – including refugee identity papers or reference from a community leader, place of worship, birth or marriage certificate
- An outline business plan that includes sales, cash and expenditure projections – ideally pre-reviewed by a business development service (BDS), business support organisation (BSO) or a community financing provider that you keep your money with. You will need to explain the purpose of a loan and how the lender can measure the eventual impact of the financing on your business.
- Records of previous sales, purchases and production costs like electricity bills or workspace rental, or of money borrowed and repaid
- Records of any personal savings with a community financing provider
- References of your character from the community and feedback from previous customers
- Photos of your product or service in action, your work premises, farm or retail place
- If collateral will be required:
  - Take a photograph of the asset or inventory pledged showing its identification marks, bar codes or serial number(s)
  - Provide an invoice or evidence of the asset's age and value
  - Evidence that you are the proprietor/owner, and the asset is not co-owned, shared or pledged as a security to someone else.
  - Record the details of the asset' s location, applicable insurance and any protection against theft or damage.

Short-term equipment, pre-shipment or working capital loans – Range: $10k to ~$5Mn

Banks dominate this category but there are now several new types of providers including telecommunications companies, impact investors and social enterprise organisations like incubators, angel investors, factors, and commercial money lenders.

To receive a loan your business will need to be registered officially and have a bank account into which a loan can be transferred. In most cases a bank will expect your business to have a minimum of 3 years consistent transactions records. The upper limit of total loan value is usually expressed as a percentage of a business's net assets, and the maximum monthly loan repayments permitted as a percentage of the lower range of recent average monthly revenues. Businesses may be pre-qualified for future transaction applications, which can then be decided quickly. Providers will ask for the documentation in Table 2, to on-board or pre-qualify a business.

Table 2.1 shows the type of additional information to submit at the time of seeking a pre-shipment or sales-order loan once a contract has been signed.

Table 2: Documents required for SME on-boarding & short-term loan pre-qualification

Theme	Documents required (example)	Document in file? Yes/No	Document file location
Business operations	Overview of your business, its markets, its unique selling points and trajectory		
	Business plans / strategic plan & references		
	Operations process map		
	Internal IT systems		
	Product portfolio summary		
	Customer & Distributor portfolio summary		
	Supplier portfolio summary		
	Supply chain vulnerability risk assessment		
	Business Resilience plan		
	Management reports		
Communications	Web site, social media & communications materials		
	Communications scrap-book		
Ownership & Human Resources	Structure of the business and its subsidiaries including any foreign entities		
	Organization chart with Key Directors and Employees identified		
	Directors profiles, CVs Remuneration and Share ownership		
	Details of beneficial owners of the business (country of residence, domicile, business ownership and shareholding)		
	Directors' and key employee contracts		
	Board minutes		
	Board resolutions		
	Business Continuity plan		
	Shareholder minutes		
Legal	Certificate of Business Registration or Incorporation		
	Memorandum of Association		
	Articles of Association		
	Business license / permit		
	Tax compliance certificate		
	Company by-laws		
	Compliance certificates		
	Procurement, sales and customer relations policies		
	Documentation on any legal cases pending or decided		

Theme	Documents required (example)	Document in file? Yes/No	Document file location
Financials	3-years of audited financial statements/Annual reports/Cash flow statements		
	Revenue and Operational expenditure projections		
	Annual budgets & Management accounts for loan period plus 6 months		
	Accounts receivables, payables and inventory reports		
	Assets register		
	Details of any legal charges or debentures over assets		
	Details of existing covenants in force		
	Financial model for next year		
	Current financial base of the business and sources of internal financing		
	Capacity of Directors to offer personal guarantees for loans		
	Tax returns		
	Off-balance sheet reports		
Contractual agreements	Debt/lease agreements for premises, equipment, fixtures & fittings, vehicles, IT, etc		
	Equity agreements (e.g., Shareholder Agreements, Stock Purchase Agreements, Stock Option Agreements)		
	Supplier agreements		
	Partnership agreements		
	All risks insurance policies		
	Commercial contracts & franchises		
Impact	Environmental impact assessment reports of operations or factors of production used		
Intellectual property information	Patent documentation		
	Trademark Registrations		
	Copyrights documentation		
	Domain registration documentation		
	Software licenses		

Table 2.1: Documents required for pre-shipment or sales order loans after pre-qualification

Theme	Documents required (example)	Document in file? Yes/No	Document file location
Sales contract & Buyers	Sales order or contract and terms of payment		
	Details of buyer's business		
	History of buyers' previous purchases / contracts and payments		
	Forward projection of frequency of shipments and value of sales (Forfaiting)		
	Products or services quality and inspection requirements		
	Proposed shipment modes and documents		
	Eventual inventory & shipment insurance		
	Items to be purchased or contracted in advance of shipment and invoicing of the buyer, and from where		
	Details of buyers' business & References		
	Details of buyers' bank and account and confirming banks, if any		
	Names and profiles of buyers' company Directors and beneficial owners		
	Bill of quantities and/or test certificates		
Updated Financials	Updated accounts and inventory records, including aged debtors and aged creditors listings		
	Supply & Distribution chain Risk assessments		
Legal	Sanctions checks completed		
	Regulatory compliance of sales order or contract		
	Sustainability and social inclusion standards applicable		
	Standards accreditation and date of last audit		
	Packaging materials climate impact rating and disposal / re-use instructions (G7 countries)		
	Product materials description & declared customs code		
	Production and delivery risk assessments for term or repeat contracts and stage payments		
	Legal representative contact details		

Long-term secured loans with banks or non-bank providers – Range: above $100k

There are many sources for obtaining financing for equipment, business development projects, acquisitions, and expansions, where repayment will take longer than one year. Some of these financing sources are backed by guarantees or insurance schemes to promote business development and reduce the risks of capital losses for the financing provider. If your business fails, loan creditors will only get paid out if anything is left after taxes, duties, employees' payroll, and preferred shareholders.

Without a capital de-risking guarantee of some sort of a bank lender is required by international regulations to hold collateral equivalent in net value to at least 125 % of a loan and charge a premium interest rate. A guarantee scheme from a higher-rated financing institution to the lending bank can cut collateral requirements and interest rates considerable, in many cases below 10% per annum equivalent. There are thematic and time-bound guarantee schemes to promote green projects, sustainability, reduction in carbon emissions and pollution, MSME recovery and resilience, social inclusion, and labour conditions. Guarantees replace the capital a bank is required to hold in the form of collateral as a regulatory cushion against default, with another higher credit-rated institution's capital. The lending bank retains the risk of default and still has to perform due diligence reviews on all the information and records a business provides with its loan application.

Insurance schemes can protect against the loss of an asset or chattel[1] being purchased, produced, transported, or held as collateral but the amount of a pay out in the event of loss is not certain. Thus, insurance schemes do not reduce capital risks or interest rates for the lender. They merely protect to a degree the collateralised asset.

Providers will ask for similar documentation as for short-term loans, but in more detail. They are legally obliged to visit to your premises, customer outlets or suppliers/ contractors of items being financed. They will scrutinise long-term business plans related to the duration of the loan or investment and will request the following additional information:

Table 3: Additional documents required for long-term loans and investor financing

Theme	Documents needed (sample)	Document in file? Yes/No	Document file location
Additional documentation	Executive summary of your business and the investment you are looking for (amount, purpose, likely result)		
	Inspirational business summary as a "Teaser / or Pitch presentation"		
	Plans and other documentation related to the item to be financed by a long-term loan, lease or investment		
	Business plan / Strategic plan with realistic projections ahead for 3 to 5 years		
	Reference materials to support the figures in your Business plan.		
	Investor memorandum or Term Sheet outlining what you are prepared to give-up in return for an investment and how the investor can exit.		
	Responses to Due Diligence checks		
	Intellectual property certifications, Trademarks and Copyright for items subject to investment		
	Resilience plans including security measures, off-site back-ups of critical information, and supply disruption recovery plans		
	Business projections for 3 or 5 years		

Tables 2, 2.1 and 3 can be downloaded from the Financing Gateway Resources pages

What should be in your business plan and what will be analysed by a lender?

Section 3.5 contains a detailed list and explanation of the checks and assessments that banks make in their initial review of an application for financing. These include looking at the ratio of your reported current assets to current liabilities over the last three years. You should perform these checks on your financial accounts yourself before submitting an application. If you do not satisfy a financing providers' criteria, do not submit an application until you have made changes to your business or can explain why, if the situation is temporary.

[1] *A chattel is a moveable asset being transformed in your business – it is usually inventory, work in progress, moveable tools and equipment*

Examples accounting ratio criteria for bank loans

Ratio	Expected Levels
Quick ratio Assets divided by current liabilities payable within one year	>1.2 X
Gearing: Debt/Equity Ratio The ratio of all loans to the amount of equity/capital in your business	<4.0 X
Interest Cover Ratio Earnings before interest and taxes divided by the cost of interest and amortisation payments	>2.5 X
Debt Service Cover Ratio Your incoming cash inflow divided by your debts that are payable within one year	>2.5 X
Asset productivity and productivity growth If you purchased assets, how much are they contributing to your business earnings: Earnings before interest and taxes divided by the net value of your assets – looked at year on year to assess the trend (growing or shrinking)	> 4.0 X

Here below in Table 4, we mention, just the main points to get right in a Business Plan. Even though a business plan is not strictly required every time for applications for short-term financing, a bank will ask for one on the first occasion you make an application to understand your business, its growth plans and financing dynamics. After one year the bank will ask to see an update of the Business Plan – so you need to re-visit the plan at least every year to account for changes.

- Long-term objective or vision:
  - Describes your company's 3–5-year plan concisely in one or two paragraphs
- Mission statement:
  - Explains the ethics and working practices of your company and the way it intends to treat its employees, suppliers, and customers
- Business plan:
  - Describes your main products or services, where and how they are sold, where your inputs and factors of production come from, and how you plan to grow your business.
  - Gives basic information about the company's leadership team, employees, and location
  - Includes full financial information on expenditures, income, cash flow and assets and realistic high-level growth plans.

MSME financing applications are challenging for both entrepreneurs and lenders, especially working through the necessary regulatory procedures, documentary requirements, and needs assessment. This level of review continues throughout the financing cycle from the first point of contact between the two parties to the final repayment and performance report. Accurate, realistic, complete, and clear communication with financing providers can greatly influence an entrepreneur's reputation and ability to access the repeated financing needs of a business.

Table 4: Key components of a business plan

Content	Description
Inspirational brochure	• Inspirational business summary as a "Teaser" for investors or new customers
Company description	• Executive summary of your business and the investment you are looking for (amount, purpose, likely result) • General company information, including details of any problems encountered and how the business solved them • Competitive advantages or differentiating factors of the business • Profile any experts on the team and their business location
Market analysis	• Summary of the industry outlook • Description of target markets • Competitor analysis • Your target markets and predicted sales
Organization and management	• Company structure, including the decision-making and operations hierarchy; include the unique experience of key company players, and show how it contributes to the success of the business • Organizational chart • Legal status of your business (incorporated, limited partnership, or sole proprietor)
Service or product line	• Describe what the company sells or offers • Indicate the benefits that customers derive from your products or services • Include intellectual property, like copyright or patent filings
Marketing and sales	• Describe how the company attracts and retain customers • Describe your marketing and sales strategies
Funding situation and plans	• Include a cash flow statement and projection • Clearly explain how much funding is needed over the next 3 to 5-year period • Outline how the funding will be used • Describe how much the new revenues the financing is expected to generate, when debts will be paid off or the business sold.
Financial projections	• Outline a prospective financial outlook for the next five years indicating to the potential financing providers the business' stability and will be a financial success • Include forecasted income statements, cash flow statements, and capital expenditure budgets • For an already established business, include income statements, balance sheets, and cash flow statements for the last three to five years. • Include any collateral the company could put against a loan

Note: include an appendix containing the supporting documents and other materials itemised in the preceding list. Verify this list against the criteria and requirements of your targeted lenders. Common items often excluded include credit histories, resumes, product pictures, letters of reference, licenses, permits, or patents, legal documents, and permits. Further, ensure that projections must are clearly explained, are coherent with the business plan and match the purpose of the loan request.

Check each page of your application before submission to ensure that all data and information is consistent throughout. Errors in data coherence are the top reason for loan application rejections.

Equity investment, business angels, crowdfunding, patient capital – Range: no limits

Investment involves an individual or entity taking a long-term participation in the growth of your business, through funding and knowledge or experience. Their contribution can be sold at some stage for a profit, usually known as return. Taking a full risk on the long-term growth of the value of your business means that investors may want to own a proportion of it through legally buying shares or contractual ownership of a business asset, like property. As an owner or founder of a business you should be willing to give up part of your business and enter a partnership with a potential investor.

The terms of an eventual sale, i.e., an exit strategy, for the investment need to be agreed upon at the start. The investor may want to sell his/her shares back to you for a minimum % share of the business value at that time or sell his/her shares to someone else on the open market. Your degree of control over the direction of your business will be reduced, and you may even risk losing control completely if other investors are brought on-board and your share of the business is diluted

A common mistake many start-up entrepreneurs make is trading a large share of their business in exchange for a relatively small financial contribution at the start when they are just happy to find one person with confidence in their business idea. As an entrepreneur, you need to plan ahead to see what other investment financing you may require if your business does well. Good businesses will pass through several "rounds" of investment, each for higher amounts. Table 3, below shows a simplistic financing plan:

Table 5. An Outline Business financing plan

Business maturity	Financing call and estimated percentage ownership traded
Start-up / business angels, venture financing	Call: $50k - $500k for 20% total business value
Series A call	Call: $500k to $1Mn for 20% total business value
Share split (if original investors agree), Series B call or Sale of % of Founders shares	Founders may maintain control >50% by increasing the number of shares, buying out investors, selling the remaining 9.9% as Series B to raise additional new funds for specific purposes.

Note: One challenge that comes with investment funding is agreeing on accurate valuations, and reference points for future valuations of a business. Licensed surveyors' that use approved valuation methodologies and certificates are required for the first legally notarised financing and when an investor plans to cash-out or sell his/her shares. This work and documentation have a cost.

In contrast to banks that provide loan services, investors need to be attracted to your business before investing their money and know-how into your business for terms normally more than 3 years. The process of attracting an investor and passing the subsequent due diligence checks can take more than one year. Getting financing is not an easy feat, but once you have passed through the initial regulatory and legal approvals and performed positively against your first major funding, the number of financing and investment options increases.

To attract an investor, you will need to complete:

- **A realistic business plan** of what your business and how it will grow with the funds sought, complete with information about valuation methods used and references
- **A prospectus** – normally a 2–4-page document marketing your business and growth plans. Prospectuses can also be in a variety of formats such as video, music or photographs
- **An "Investor Pack"** containing similar information to that required for a long-term bank loan, but additionally information on how the investor may redeem a return

Potential investors will normally expect to visit your premises, sales outlets, and suppliers with you to really get to know your business and your working practices before committing funds. You should expect them to engage in your business decisions. The legal agreements with investors may contain covenants designed to protect both the value of an investment and the reputation of the investor. Covenants may restrict what you pay yourself or others from the business, what you can do with key assets, what types of product or service you sell (e.g., no arms or dangerous chemicals) or where, to whom, you sell your products and services and what happens if the business fails and gets closed.

The following section contains more information about the regulatory considerations of banks and legal considerations of investors. It explains why lenders and investors ask for specific information and records.

Country and sector Insights, links, and references

The hyperlinks and references below show where you can find more information, enterprise insights and assistance:

Country	Link or reference
Rwanda	Sources of microcredit Sources of venture capital Business incubators
Tanzania	Sources of microcredit Sources of venture capital Business incubators
Uganda	Sources of microcredit Sources of venture capital Business incubators
Kenya	Sources of microcredit Sources of venture capital Business incubators