

Free Guide

Financing Your **Small Business**

How to Borrow Money from Relatives,
Friends, and Other People You Know

Second Edition

SCORE[®]
Counselors to America's Small Business



www.circlelending.com
800.805.2472

About



Based in Cambridge, MA, CircleLending, Inc. is a rapidly growing financial services company uniquely serving the needs of the interpersonal lending market in the United States. The company offers a suite of services (geared for small businesses) that provide for any combination of: loan documentation, electronic billing, payment processing, loan security recording, and loan account services to facilitate transactions between private parties.

CircleLending is widely regarded as the nation's first company to provide a complete solution to reduce the financial and emotional risks associated with loans between relatives, friends, and other private parties. The company has been profiled in *Time*, *Inc.*, and *Entrepreneur* magazines, *The Washington Post* and *The Wall Street Journal*, and has also been highlighted on *CNN financial network* and *National Public Radio (NPR)*.

For more information, visit www.circlelending.com/sbb



The SCORE Association, headquartered in Washington, D.C., is a nonprofit association dedicated to the entrepreneurial education and the formation, growth, and success of small businesses nationwide.

SCORE's 10,500 retired and working volunteers provide free business counseling and advice as a public service. From marketing advice to finances, sales and operations, SCORE counselors will help you find the answers. Just as important, counselors will help you develop and think through your business plan to make sure you're asking the right questions.

When you seek help from a SCORE business counselor, you get the benefit of all his or her ideas—and the continuity of knowing that someone who knows and understands your small business is available for ongoing support. Seeking advice from a SCORE counselor provides a distinct advantage as you go forward. SCORE is a resource partner with the U.S. Small Business Administration (SBA).

For more information, visit www.score.org

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Use a friend or family loan to build your credit.

When you choose to have CircleLending set up and manage your loan from a friend or family member, you will have the option to activate our Credit BuilderSM feature.

**See Appendix for details
and a money-saving offer.**



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Table of Contents

Section	Title
Introduction	Message to Our Readers
1	Debt vs. Equity Financing
2	Common Concerns of Small Business Borrowers
3	Thinking like a Lender
4	Determining Who to Approach for Money
5	Elements of a Strong Loan Proposal
6	Overcoming Common Lender Objections
7	Small Business Owner Testimonials
8	Summary
Appendix	Build Credit with a Friend or Family Loan



Did you know?

Family and friends can be a good source of financing, especially in the early stage of your business when relatively small amounts of money are involved.

Message to Our Readers

Whether you are just starting out or looking to expand, financing is an essential part of any small business. Proper financing can mean the difference between success and failure.

According to the Global Entrepreneurship Monitor, U.S. start-ups and growing businesses receive more than \$129 billion from informal sources—this includes money that comes from family, friends, and other private parties.

To successfully borrow money from people you know, it is important that you overcome:

- 1. Financial Risk:** You must demonstrate to people who might be potential lenders that your business has a reasonable chance of success, and that their investment in it is a smart one. Lenders will want to see that you have the necessary skills, have thought about the risks involved and have a plan in place to minimize these risks while growing your business.
- 2. Emotional Risk:** You must convince people who might be potential lenders that investing in your business will not jeopardize their relationship with you. The information, worksheets, and examples contained in this document will help you to overcome this barrier, and bring you closer to getting the money you need.

When it comes to borrowing money from people you know, we realize that small business owners will be at different points in the process—some of you may be uncertain as to where or how to begin, while others may already have specific lenders in mind. This guide is organized so you can select the appropriate section(s) based on your individual situation and specific business needs.

Should you have any questions, please feel free to contact CircleLending at **1.800.805.2472** or visit us online at: www.circlelending.com/sbb

Sincerely,



Asheesh Advani
President
CircleLending, Inc.

Debt vs. Equity Financing

Although this guide focuses on how to borrow money from people you know, it is still important to understand the types of financing that are available to small business owners. This way, you can determine which type, or combination of types, makes sense for your situation. After all, it is not uncommon for small business owners to receive financing from several sources, one of which is usually friends, family, and other private parties.

Debt Financing is money that you will pay back, usually with interest, over a set time period and in accordance with specific terms. Some traditional sources for debt financing are banks and credit cards.

There are also numerous programs offered by federal, state, and local governments that hope to encourage the growth of small businesses because of the positive effects they have on the economy.

Another source for debt financing is borrowing from people you know, such as family, friends, and business associates. Many of today's successful companies, including Motown Records and Crate & Barrel, started out this way.

Equity Financing involves giving up a portion of the ownership of your business in exchange for money received from equity investors.

Because equity investors are buying a piece of your business and essentially becoming joint owners, if the business fails you generally are not obligated to pay the money back. On the other hand, if the business succeeds, equity investors share in the financial success well beyond recouping the money they originally invested into the business.

Common sources of equity funding:

- Venture Capitalists: professional investors who are looking for a higher rate of return by investing in high-growth business ventures
- Angel Investors: high net worth individuals who invest in businesses on a private basis

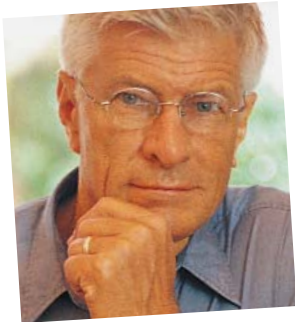
Did you know?

> **Businesses in existence for less than two years typically find it difficult to get loans from commercial lenders because the businesses are viewed as a high credit risk.**

Debt vs. Equity Financing: Pros & Cons

Debt Financing	Equity Financing:
<p>Pros:</p> <ul style="list-style-type: none"> - Typically easier to get than equity financing - Wide range of options available (e.g., bank loans, lines of credit, family and friend loans, etc.) - Allows you to retain control of your business 	<p>Pros:</p> <ul style="list-style-type: none"> - Investors can provide expertise and key contacts - Usually available in larger amounts than debt financing - If business fails, you usually don't have to pay back the money
<p>Cons:</p> <ul style="list-style-type: none"> - Collateral is sometimes required - Amount you can borrow is usually limited - If business fails, you still may have to pay back the money 	<p>Cons:</p> <ul style="list-style-type: none"> - Investors may demand a say in running your business - Requires additional time to manage investor expectations - You forfeit sole ownership of the business and its profits - Investors will not earn a return for several years, creating apprehension and impatience for some.

Common Concerns of Small Business Borrowers



While family and friends can be an excellent potential source of financing for your business, as a borrower you may still have some concerns about mixing money with people you know. You are not alone.

Below we have listed the top concerns of small business borrowers that we have identified based on our experience. Underneath each concern we have provided a rationale that should help ease your worry.

1) Borrower concern: "I am worried lenders will meddle in how I run my business."

How to minimize this concern: By formalizing the loan through proper documentation you will make it clear that this is indeed a loan, and not a favor, which means your lender's role does not extend beyond just that—a lender.

2) Borrower concern: "I'm concerned that my lender will scrutinize everything I do financially that isn't related to the business. For example, if I take a vacation will they wonder if I'm doing it with their money?"

How to minimize this concern: By setting up a mutually agreed upon repayment plan, your lender will know that you are serious about paying back the loan. Because they will be receiving steady payments, any concerns they might have about how you are spending money should be alleviated.

3) Borrower concern: "Won't my lender worry about my business failing?"

How to minimize this concern: Yes, that is a risk they're made aware of. However, if you secure your loan with collateral, your lender's risk is significantly reduced. In the event that you default on the loan, your lender will be entitled to receive something (e.g., a vehicle, office equipment, etc.) in lieu of being repaid. In addition, your lender can claim the defaulted loan as a capital gains loss - as long as the loan is documented and they have tried to collect missed payments.

4) Borrower concern: "Even after I pay my lender back, are they going to feel as though they did me a favor, and that I still owe them something?"

How to minimize this concern: By talking to your lender up front and formalizing the loan process, you make it clear that this is a business opportunity, not a favor. Also, if you let your lender earn a fair interest rate on their investment, there is no reason why you would owe them anything after the loan is repaid.

5) Borrower concern: "What if I have trouble paying back the loan?"

How to minimize this concern: Generally, when you borrow from friends and family, you have more flexibility (compared with a commercial lender) in how you pay back the loan. If you are having difficulty making payments, be upfront with your lender about your situation, then suggest an alternative repayment plan that works for both of you. In most cases, your lender will appreciate your proactive response and accommodate your request.

Thinking like a Lender

Before you approach someone you know for money, you should first understand the traditional loan approval thought process of a commercial lender, such as a bank. This is important for two reasons:

- > The person you approach for money may follow a similar thought process, and you will need to provide the necessary information just like you would to a traditional lender.
- > Even if the person you approach doesn't follow this thought process, by providing some or all of this information you are demonstrating your business knowledge and professionalism, both of which can increase your chances of obtaining the money you need.

The typical loan approval thought process:

1. Management Experience & Expertise.

Lenders need to feel comfortable that a borrower has the necessary background and skill set to effectively operate the small business.

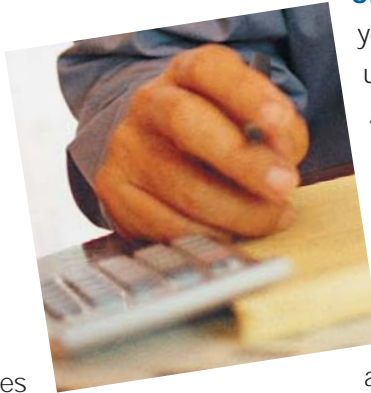
2. Detailed Business Plan.

Lenders usually require start-up businesses to have a business plan that includes income and expense projections for the first three years of operation.

3. Cash Injection.

Lenders want to know how much money the borrower has at risk. For start-up businesses, commercial lenders typically require at least a third of the total project costs to be covered by the borrower.

4. Collateral. To reduce their risk in case of default, lenders often require the borrower to secure the loan with collateral. This is usually hard goods such as office equipment, vehicles, etc., but sometimes it can be against accounts receivables depending on the business' current cash flow.



5. Personal Character.

In addition to your experience, lenders also try to understand who you are as a person. As a result, some lenders will conduct background checks that can include looking for any previous litigation or bankruptcy information.

6. Credit History.

Lenders like to see a good credit history. If there are any credit issues, an explanation will be required. Different lenders have different levels of tolerance when it comes to credit issues.

7. Personal Financial Statements.

Lenders like to see a list of personal assets and personal liabilities. Do not include debt paid by your business. Include other sources of personal income.

Did you know?



Investments by family and friends account for more than 50 percent of all investment dollars for start-ups.

Determining Who to Approach for Money

At first, trying to determine who to approach for financing may seem like a challenge. Many small business borrowers feel they don't know enough people who are in a position to lend them money, and who they are comfortable approaching.

To formulate a list of potential lenders, consider these helpful steps:

- Write down the names of everyone you know, regardless of how remote the relationship. This might include family, friends, colleagues, mentors, teachers, neighbors, etc.
- Circle the names of the people who have some insight into your character and/or personal and business skills.
- Think about a realistic amount of money each person might be able to lend you, and write down that amount next to their name.

FACT

Ahmet Ertgun, founder of Atlantic Records, borrowed money from his family dentist.

Target Lender Description	Target Lender Name	Amount Requested	Amount Obtained
Parent	Jane Smith	\$5,000	\$5,000
Uncle	Joe Thompson	\$3,000	\$2,000
Friend	Pete Williams	\$2,000	\$1,500
	Totals	\$10,000	\$8,500

IMPORTANT BORROWING TIP

Consider borrowing from several people rather than trying to get it all from one person. This way, you can ask for an amount from each person based on what they can afford to give you, and not on what you need.



Elements of a Strong Loan Proposal

When approaching someone you know for money, it is important that you develop a strong loan proposal that backs up your request with facts and figures. Merely asking for the money is practically a guarantee that you will be turned down.

Consider the following:

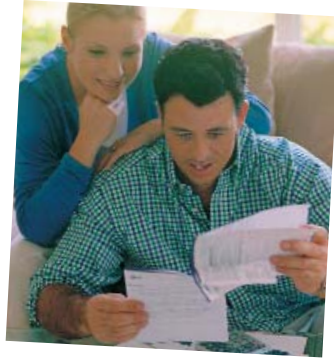
1. Financing Overview. Show potential lenders exactly how much money your business will require, and tell them what other sources (if any) you are using to obtain financing.

2. Legally-Binding Loan Agreement.

Let potential lenders review an actual loan agreement. Seeing an agreement in writing will show your

commitment and make potential lenders feel comfortable about giving you the money.

3. Collateral List. By identifying items you are willing to use as collateral to secure the loan you are demonstrating that your lender's investment is protected.



4. Loan Type Options. From start-up business loans to seasonal loans, the type of loan you propose impacts how you will repay it.

5. Payment Schedule. Based on which loan type you select, review a sample payment schedule to show potential lenders how the loan would be repaid.

6. Outsourced Loan Servicing. Consider using a loan servicing company to manage the repayment process, which includes payment processing and record keeping. This will reassure your lender that they won't have to deal with awkward conversations that might inhibit your relationship.

Did you know?

> Default rates on informal loans drop from 14 percent to less than 5 percent when a repayment installment plan is used in lieu of a lump sum payment.

Use CircleLending to quickly and easily handle everything listed above, and build credit in the process. See Appendix for details and a money-saving offer.

Overcoming Common Lender Objections

Potential lenders may object to giving you money for a variety of reasons. Sometimes they may tell you why, other times they may not. Either way, it is important for you to understand these objections so you can respond to them appropriately.

Below are four categories of lender objections, as well as suggestions for how to overcome them:

1) Financing Objections: These objections typically focus on the lender's financial situation.

Lender objection: "I don't have the money to give you."

Suggestion to overcome objection: Consider asking for a lower amount. Try to find out how much money your lender can afford to give you.

Lender objection: "I can't access the money. It's tied up in an investment, retirement plan, etc."

Suggestion to overcome objection: Encourage your lender to contact their [financial advisor, accountant, etc.] to find out if they can move the money without being penalized. For example, some retirement accounts and annuity plans allow money to be lent to a small business without paying a penalty or taxes.

2) Business Risk Objections: These objections typically focus on the lender's perception of your business.

Lender objection: "I don't believe your business will succeed."

Suggestion to overcome objection: Review your business plan with your lender to show them why you believe the business will succeed. Consider asking your lender for suggestions on what improvements you could make so they feel more comfortable about your business.

Lender objection: "I don't think you have the skills to run your business."

Suggestion to overcome objection: Emphasize your experience. Talk to your lender about former jobs you've held that relate to your small business, entrepreneurial classes you have taken, or people you plan on hiring.

3) Relationship Risk Objections: These objections typically focus on the lender's perception of how lending you money will impact their relationship with you.

Lender objection: "I'm concerned that our relationship will suffer if there's a problem paying back the loan."

Suggestion to overcome objection: Recommend using CircleLending to manage the repayment process. This way, there's a buffer between you and your lender. Also, you will have loan restructuring tools so you can change the repayment schedule to ensure that it works for both parties.

Lender objection: "What if we disagree over the terms of the loan after the fact?"

Suggestion to overcome objection: Emphasize that everything will be documented in writing, and that detailed records will be kept—all of which can be handled by a neutral third party.

continued on next page

Overcoming Common Lender Objections continued

4) Outside Pressure Objections: These objections typically focus on external factors that affect the lender.

Lender objection: "My [significant other] won't like the idea of my lending you the money."

Suggestion to overcome objection: Offer to review your loan proposal with your lender's significant other. Also, consider recommending the use of a neutral third party to handle the process.

Lender objection: "I have a friend who lent someone money and never got paid back a dime."

Suggestion to overcome objection: Emphasize that if the loan is set up and managed correctly, the chance of successful repayment is much higher. Additionally, you should stress why you are a good borrower. You might even offer to share your credit history to prove it.

Not sure how to respond to a lender objection?

Call CircleLending at 1.800.805.2472 to speak to a small business specialist.



Did you know?

> An SBA-sponsored study found that solo entrepreneurs expected their start-up costs to average \$6,000.

Testimonials

Why it makes sense to have CircleLending set up and manage your loan from a relative or friend.



Business Consultant

"My best friend felt more comfortable about loaning me money after I told him about CircleLending. I think the automatic debits and credits made a big difference." – E.H.

"My sister liked the idea of using CircleLending because she earned 10% interest on the loan, which was five times higher than what she was earning in her money market. I liked the fact that I was able to get a flexible, low-interest loan from her with no hassles." –R.C.



General Contractor



Daycare Center Owner

"When my aunt and I used CircleLending to handle our loan, all the record keeping and payment processing was done for us. I was able to focus on my business instead of worrying about my loan, and my aunt felt better knowing that her account was automatically being credited every month." –D.W.

Did you know?



A loan from a friend or family member can be used to build your credit, but only if you use CircleLending's Small Business BuilderSM service. See Appendix for details and a money-saving offer.

Summary

The key to approaching friends, family, and other people you know for money is to be open and honest. Focus on the people you believe not only have the resources, but are also likely to have insight into your character and will be interested in your business.

Ask only for an amount that your potential lender will be comfortable giving, and make it clear that a refusal won't offend you or hurt the relationship.

Agree to terms formally in writing, and detail how you will repay the loan. Consider using an outside loan servicing company to manage the payment process and maintain accurate records.

Above all, be as business-like as possible.

Keep in mind



When someone lends money to a small business owner, they are investing in an opportunity.

Small Business Builder Service

Get more than money when you borrow from relatives and friends

SAVE 30% off the Set-up Fee

When you choose to have CircleLending set up and manage your “friend and family” loan, you will have the option to activate our Credit Buildersm feature. That means you can use your loan from a relative, friend, business colleague, or other private party to build your credit.

CircleLending’s experienced team will:

- Handle all aspects of loan documentation
- Manage the entire loan repayment process
- Secure the loan with collateral (if desired)
- Help build your optional credit rating with our optional Credit Buildersm feature
- Provide you and your lender with password-protected accounts
- Maintain accurate records
- Generate year-end reporting for tax purposes
- Provide toll-free client service and email support

SAVE 30% off the Set-up Fee by mentioning Code: SBF2

For more information:

800.805.2472

www.circlelending.com/sbb