FINANCING SOURCES IN TODAY'S ECONOMY TO BUILD OR EXPAND YOUR FRANCHISE BUSINESS.

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By: Kay A. Anderson

Being puzzled by the consolidations and changes in the lending environment in recent months, many franchisor executives have arrived at the realization that it's time to consider diversifying financing sources to better insulate licensees from ever-changing and tightening credit policies. So, why is financing sometimes such an obstacle in the franchise development and expansion business? Because traditional lenders (banks and savings & loans) have historically based credit decisions on the strength of your licensee's collateral ("hard" assets); and many non-traditional lenders (non-bank lenders, insurance companies, leasing companies) who are often considered "cash flow lenders", may be caught up in mergers, reorganizations, declining secondary market conditions and new credit policies. What's the best way to insure your success in establishing and maintaining relationships with lenders who won't "derail" your development goals? By carefully selecting a lender who has a demonstrated understanding of your business and who has recently approved and closed loans similar to what your licensees are seeking.

The First Step In Getting Your Franchisees Financed…

In order to be in a position to find the "right" lender for your financing needs, you must first become familiar with the current lending parameters that make sense in today's economy. If you are new to the franchise business or are expanding beyond your historical (i.e., geographic) operating environment, the chances are excellent that lenders will use one of the government assisted (the "504" program) or guaranteed ("7a") loan programs offered through the U.S. Small Business Administration. These programs provide financial enhancements to lenders to make loans for start-up businesses, expansions, and acquisitions or for industries where the risks associated with the particular industry may not be acceptable to the lender. The SBA criteria for eligibility favors the entrepreneurial spirit, so be prepared when evaluating financing sources, to hear about these products.

For you to properly evaluate whether any particular lender will be a good fit for your needs you should be prepared to present the following information at the start of the interview process:

- Description of the "typical" detailed, total project development cost and franchise required minimum equity/liquidity (if any)
- Generic financial projections for profit and loss (cash flow) during initial year of operation for a typical licensee (earnings claims)
- Description of what experience characteristics have produced successful operators in your franchise's past history
- Description of the franchisor's screening process for new applicants and training process for successful candidates
- Up to date financial statements on franchisor
- Description of expansion plans (beyond what appears in UFOC)
- Typical number of start-ups, acquisition/conversions, resales (relicensings) and renovations that will be completed in the next 12 months

- Details concerning your franchisee "population"…i.e., primarily single unit operators, multiple unit operators, backgrounds, financial strength, etc.
- Copy of the UFOC
- Information concerning how the franchise development team is organized and the type of assistance that is currently provided to licensees to assist with their financing needs

Once you have most of the above compiled you are ready to begin the lender review process.

<u>Tips For Selecting a Lender…</u>
Now that you have a "prequalification" package of information ready for a lender to look over, where do you start in determining the best alternative for getting your licensees financed in the shortest time frame with the least amount of aggravation?

Note: I always recommend that licensees be directed to start with their local bank for their franchise financing needs…that's the bank where they currently have a deposit relationship and where, hopefully, the lender is familiar with their financial background. Why? Because this is the lender who will factor into the loan pricing equation, the earnings that the bank expects to receive by maintaining an overall banking relationship, i.e. deposits, other loans, etc.…If approved, this could result in an interest rate savings of ½ to ¾ point on the loan. Of course, if that "relationship" lender is not interested in financing the type of business needing funding, then, most likely, the franchisee will turn to you for guidance. The balance of this article assumes that the franchisor's objective is to provide direction for licensees seeking additional sources for financing.

- Find a lender that "admits" to being a cash flow lender. The start-up franchise business is one that often time cannot be fully collateralized by the assets in the business. Make certain that the lender is not going to penalize a licensee for this fact at a later date (for example, as a condition of the loan approval).
- Ask the lender to describe the most recent franchise deal that he closed and the last transaction in your line of business that was approved. Of course, take particular note if the lender is not familiar with your business or has trouble recalling any loans funded recently in this industry! Note carefully comments by the lender concerning whether any similar loans funded were for start-ups or existing business. Ask specifically about what type of business AND personal collateral was required. Determine what kind of experience the applicants were required to have in order to meet the lender's management requirements. Note carefully the terms of the loan and any loan covenants.
- Ask the lender about any "hard asset" or "loan to value" requirements that the lender has…these are very important to getting the deal structured correctly and will provide guidance to you concerning what type of business and personal collateral will be required in order to get a loan approved.
- Determine the lender's "footprint" for funding loans, i.e., its geographic lending area and make certain that it is a good match for your development goals. It may be more advantageous to have several lenders who are experts in differing areas of the country than one "national" lender.
- Ask the lender what the average sized loan is this year that the bank has funded? Think about whether your loan requests will fall above or below this average.

- Obtain a good understanding of the paperwork process…who does what, who makes the loan decision, who closes the loan, etc.
- Ask about how long it takes to approve, package and fund a loan
- Ask about the lender's current lending guidelines for your franchise business….most likely the lender won't show you a copy of the actual credit parameters, but that's the key to determining whether your loan requests will ultimately fit the lender's guidelines.
- Determine the lender's expertise in processing SBA loans….Do they seem to have a level of experience with the SBA or do they simply use the SBA loan programs on an occasional basis?
- Ask whether the lender is willing to pre-qualify your licensees for financing
- Request that the lender consider approving the loan (i.e., issuing a conditional commitment) PRIOR to finalization of an exact site for the franchise business
- Finally, a good lender should be willing to discuss different ways to structure your loan request in order to maximize your objectives.

Using the above criteria you should now identify three or four lenders that have satisfied your inquiries and who seem anxious to work with your franchisees.

Ongoing Lender Communication…

Once you are satisfied that you have identified several lenders that meet your criteria, convert your understanding of their loan parameters and your relationship to writing. Be sure to mention that you expect regular written updates of your pipeline of applicants and immediate notification concerning any changes in the lender's credit policy that would impact your licensees.

Now that you have the tools to select appropriate lenders for your licensees needs, make sure to maintain open lines of communication that will be beneficial in providing early warning signals concerning changes in policies that would necessitate expanding the search for additional financing sources.

Kay A. Anderson, Sr. Vice President/National Accounts Manager. Temecula Valley Bank. 1-800-771-5911. Temecula Valley Bank specializes in loans to franchisees throughout the United States, using the SBA loan programs.