Big up SMALL BUSINESS

BUSINESS SENSE 101:

PREPARING TO ACCESS FUNDING

In partnership with

TUI CARE FOUNDATION

the Travel Foundation

Tourism Product Development Co. Ltd
TPDCO

INTRODUCTION

This is the fourth in a series of manuals, designed to help small and medium tourism businesses in Jamaica get to grips with some of the essential elements of business planning and management.

This manual aims to help you:

- Understand different expense types for your business
- Know about the different types of funding available to small businesses
- Be confident in assessing your business' financial needs
- Understand how to approach funding agencies
- Be able to complete applications for funding
- Be aware of alternative financing approaches

With thanks to Graft Ventures for their preparation of the content of this manual. www.graft.ventures

GRAFT VENTURES

Why you probably don't need funding (yet) ...

Yes, this is a guide for small businesses to access funding, however, you probably don't actually need funding yet. The path to identifying and accessing financing can be long, strenuous and frustrating. It is best to start this funding path from a neutral mental space than with a perception of critical priority which can distract you from other business opportunities. Treat this document as a preparation guide to be ready for financing, when needed, rather than a guide to immediately access funding because you want it now.

Managing Expectations

When to use this guide:

- You have a new product or service you are planning to launch in six months or greater
- You have existing business operations and want to improve your cash flow
- You would like to make a major purchase in 6 months or greater
- You would like to refinance existing debt or other finance instruments to save money
- You want to expand your business in six months or more

When not to use this guide:

- If you're going to run out of cash within the next two months, this guide won't help you.
- If you've started a project and you have project expense overruns and it's about to fail - it's probably going to fail.

Rule 1: When considering funding, make sure that you're investing in ways to reduce costs, increase revenue or both. If funds are not being used for increasing operating efficiency, then this guide is not for you.

Document Your Business

The first step of financing is to define what you do. Get a sheet of paper or your preferred medium and write one sentence for each the following:

- Business name and when and where it was registered
    - E.g. Acme Inc was registered in Guyana in 1955
- Primary operating activity of the business
    - E.g. The business manufactures equipment and props for the film industry
- Locations where operating activities occur
    - E.g. manufacturing takes place in Guyana and products are distributed globally, we offer installation services in English speaking Caribbean, Los Angeles and New York
- Size of existing customer base
    - E.g. Acme Inc has served 300 customers over the past 55 years
- Current annual revenue
    - E.g. Acme generates $5M in revenue annually
- Number of employees
    - E.g. The company employs 55 full time employees and 30 seasonal employees

💡 Pro Tip: Complete this before moving to the next section. It makes the process easier and you're less likely to become overwhelmed.

What Are Your Funding Needs?

Documenting Your Financing Needs

To help simplify the process, let's begin to document the reason why you're seeking financing. Click on the links below to read about three key things to understand before completing this section:

- Growth Strategy
- Organic Growth
- Cash Flow

Now that you understand those terms, you should start creating the following documents if you don't already have them:

- **Growth Strategy** - To document how the business will expand over the next couple of years. Click here for video guide.
- **Cash flow projection - existing operations** - Document the next year's worth of operating activities as if nothing new is happening. Use the cash method for best accuracy.
- **Cash flow projection - new activities** - Document cash flow specifically for new activities that you outlined in your growth strategy. Only document new activities so you can later merge this with your existing cash flow model created above. Use the cash method for best accuracy.

Make special note of all the months where cash flow goes into the negative. Don't be scared, this is normal and it's how you will determine the amount of financing you need, when you need it and what type.

Click here for Cash Flow video guide also here's an alternative video.

💡 Pro Tip: Start this process on your own and then include your accountant. It's easy for an accountant to create a cash flow statement or projection, but if they don't understand the business activities then it will be less accurate.

Document your need for financing by completing the following:

To ensure the long term sustainability of <insert business name> and consistent growth, the management team plans to execute our growth strategy of <insert two sentences on key activities from growth strategy>. This strategy is based on <Organic and/or Inorganic growth> and is expected to add <value of revenue from new activities cash flow projections > per year in revenue.

Expense Types

Before identifying sources of funding, evaluate what you're spending the cash on and when it is needed. New initiatives that require funding typically have two categories of spending - Operating Expenditure and Capital Expenditure.

Capital Expenditure
Capital expenditures (CapEx) are funds used by a company to acquire, upgrade, and maintain physical assets such as property, plants, buildings, technology, or equipment: *https://www.investopedia.com/terms/c/capitalexpenditure.asp*

Operating Expenditure
An operating expense is an expense a business incurs through its normal business operations. Often abbreviated as OPEX, operating expenses include rent, equipment, inventory costs, marketing, payroll, insurance, step costs, and funds allocated for research and development:
https://www.investopedia.com/terms/o/operating_expense.asp

💡 Pro Tip: In your budget and cash flow projections, categorise each expense line item as OPEX or CAPEX to help determine how you will finance that expense in future.

Knowing the type of expense is going to help determine what type of financing you need and the acceptable terms of that financing.

Cash Flow Modelling

To understand how much financing you need and when, you will need to create a combined cash flow projection. Take the two projections you created above and merge the activities. Some months that were previously negative may now be positive, others may be even more negative. This demonstrates how your existing operations will support or exacerbate the impact of your new growth activities. [Here's a quick video on how to create a cash flow chart](#).

Once you have created your chart, the deepest line of the chart is what's referred to as a cash flow trough. This is the minimum amount of financing needed to ensure the business doesn't run out of money.

[Use this article to help with your cash flow projection](#)

Types of Financing

Grant Funding
A business grant is a sum of money for small businesses and, unlike business loans, you don't have to repay a grant. Business grants are typically awarded by government institutions, private businesses, and other organizations. A drawback of business grants, however, is that many businesses will not qualify for them, and competition is fierce among businesses that qualify. Read more here.

Micro Financing
Microfinance is the delivery of financial services in small amounts – mainly loans but increasingly savings and insurance – to entrepreneurs who typically do not have access to mainstream or traditional financial services. A microfinance institution refers to an organization that delivers small loans to help entrepreneurs create and grow a business. You can read more about micro financing here.

Commercial Loan
A commercial loan is a debt-based funding arrangement between a business and a financial institution such as a bank. It is typically used to fund major capital expenditures and/or cover operational costs that the company may otherwise be unable to afford: *https://www.investopedia.com/terms/c/commercial-loan.asp*

Click here for a guide to decide between secured and unsecured loans.

Alternative financing

Although most companies are funded through loans or equity based investments, financiers have created derivative products to meet the needs of business operators. These options are typically higher cost, to suit high risk companies who need short term financing. Two common examples are revenue based financing and receivables financing.

Revenue Financing: Revenue based financing is an instrument where a financial institution provides capital to a company and gets repaid through gross revenues. This form of financing is usually used to support cash flow needs for operating activities (OPEX). Revenue based financing is most popular with institutions that also offer payment channels - like E-commerce stores and Retail stores with Point of Sale (Debit or credit card) machines. For example:

- Acme inc is a customer of Big Bank Co
- Big Bank Co. processes all payments for Acme Inc through their e-commerce store and in person with a POS machine
- Acme needs some cash now for payroll and other expenses
- Acme enters an agreement with Big Bank Co to get cash quickly and in exchange the bank can deduct the payments up front through their payment channels
- Acme receives $50K from the Bank and agrees to pay back $15K monthly
- Customers spend $100K with Acme Inc over the period of a month via online and POS channels
- The Bank deducts $15K from the revenue received and pays Acme $85K

Receivables Financing: When a company generates an invoice to be paid for products or services, there are normally payment terms for that invoice, ranging from immediately due to 120 days. These payment terms and even delayed payments increase the length of the cash flow cycle for a business because they've executed the work but still have not been paid for it. A few institutions offer receivables financing where they provide the company with a percentage of the invoice value, and the customer pays the financier at the agreed time. For example:

- Acme Inc charges Tour Company Ltd. $5,000 for services. The invoice terms are 14 days credit
- Acme should be paid $5,000 within 14 days of the invoice date - the due date
- Acme needs some cash now for payroll and other expenses
- Acme enters an agreement with Receivables Financing Co to provide receivables financing
- Receivables Financing Co pays 80% of the invoice amount and charges 1% monthly on the entire invoice
- Acme Inc receives $4,000 immediately
- Tour Company Ltd. pays Receivables Financing $5,000 for Acme's invoice
- Receivables Financing deducts their financing charge from the remaining $1000 and pays it to Acme Inc
- Acme Inc received $4,950 on their $5,000 invoice

Equity Financing

Equity financing is the process of raising capital through the sale of shares. Companies raise money because they might have a short-term need to pay bills or have a long-term goal and require funds to invest in their growth. By selling shares, a company is effectively selling ownership in their company in return for cash. Equity financing can be completed via multiple approaches which typically fall under the categories of private equity, public equity and venture capital.

Private Equity Financing is an alternate mode of private financing, which is composed of funds and investors that directly invest in private companies. These companies are not listed or traded on any stock exchanges.

Private equity investors generally work towards funding new technology, making new acquisitions, expanding working capital and bolstering balance sheets of companies. Private Equity firms also work in the same manner like Venture Capitalists – invest in the long term in start ups to help them grow and then reap benefits after the companies go public or merge with other firms. Read more here.

Public Equity Financing is the process of selling shares to the general public to raise capital. This is initially done through an Initial Public Offering (IPO) and facilitated by an investment bank that structures the offering and manages the listing process. After an IPO shares of the company are listed and traded on the stock exchange.

Pursuing an IPO process has been attractive to small and medium businesses in the Caribbean thanks to the Jamaica Junior Stock Exchange which provides incentives to listing.

Venture Capital is a type of private equity investing that involves investment in earlier-stage businesses that require capital. In return, the investor will receive an equity stake in the business in the form of shares.

Companies that raise venture capital do so for a variety of reasons, including to scale the existing business or to support the development of new products and services. Due to the capital-intensive nature of starting a company, many venture-backed companies will operate at a loss for many years before becoming profitable. Read more here.

What type of financing do I need?

A common mistake business operators make is thinking that they need one type of financing to fund their operations. What most should consider is a blend of finance where you match the cost of financing with the returns you will generate (new revenue or money saved). Here are some tips to consider:

Avoid compounding debt. For example:
- Taking short term loans to pay long term loan payments.
- Engaging revenue financing on all your income when you have other monthly payments. Use it for key situations like peak seasons where you generate more cash.
- Engaging receivables financing for all revenue when you have other monthly payments. Utilise this option for specific large invoices with long payment terms, and just enough to meet your cash flow needs.

Try to get the lowest blended rate possible. For example:
- Secured commercial debt is usually the cheapest option, so if you qualify, try to maximise that option to reduce interest costs.
- Supplement long term debt with short term debt where you have seasonal cash flow issues.
- Don't over-borrow. If you're taking a long term loan, and won't need the cash within a year, wait a year to borrow the additional funds.

High Risk, High Reward
- If you're engaging in a high risk initiative, you may not want to borrow against major assets that would cripple your business if the initiative fails.
- Inversely, if you're investing in a low risk initiative, you probably don't want to fund it through lending instruments with high APRs.

The table below outlines a quick matrix of when to choose different funding options:

Instrument	Short Term Capex	Short Term Opex	Long Term Capex	Long Term Opex	Low Risk	High Risk
Microfinancing	Yes	Yes	No	No	No	Yes
Commercial Debt - Unsecured	Yes	Yes	No	Maybe	No	Yes
Commercial Debt - Secured	No	Maybe	Yes	No	Yes	No
Private Equity	No	No	Yes	Yes	Maybe	Maybe
Venture Capital	No	No	Yes	Yes	No	Yes
Public Equity	No	No	Yes	Yes	No	Yes

💡 Pro Tip: Review your cash flow projections and decide on what types of financing may be useful. Then update your cash from financing activities to include timing and value of financing to support the different activities you have planned. Make sure you include the monthly payments in your cash flow model.

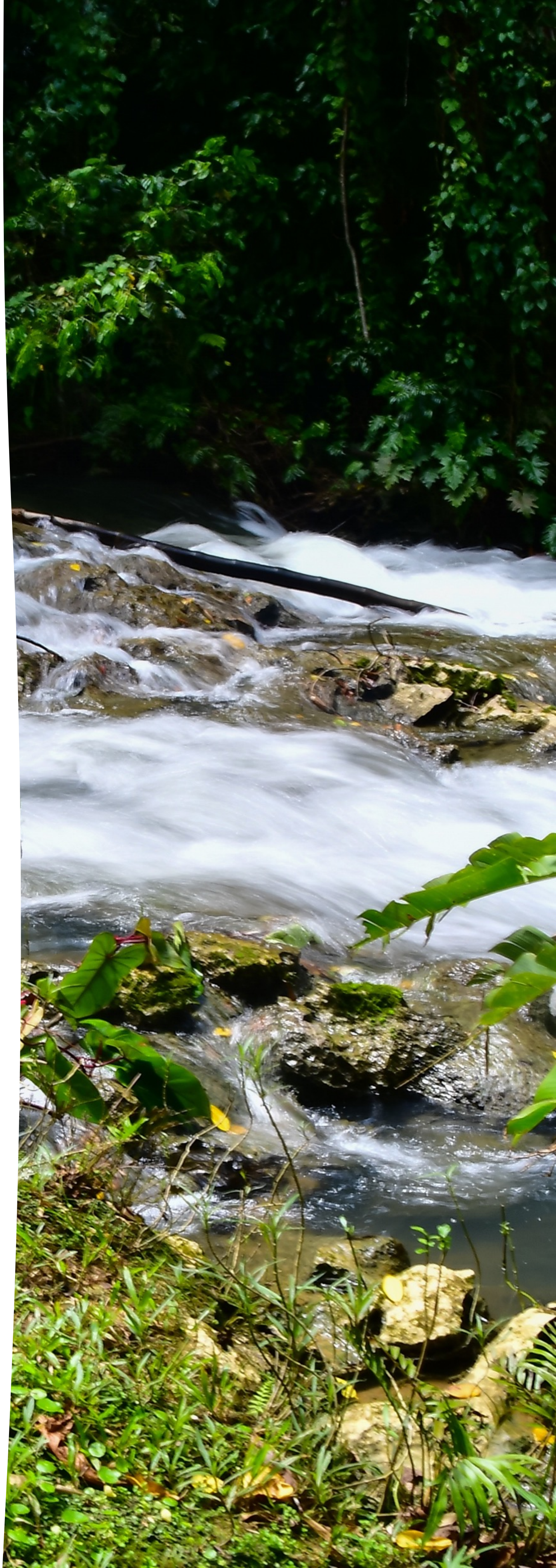
Identifying Financing Options

This is the last stage of finance planning, you now have an understanding of your needs, types of financing available and when to use them. Just as if you were buying a house or car, you need to shop around and get pre-approved for financing. Before you can commit to choosing a financing product or which institution it's critical that you gather your options and use accurate rates in your cash flow model.

Preparing Your Application

To evaluate the opportunity risk, financiers are going to ask for supporting information before providing you with an offer. Financiers are less concerned with what you're asking for, and more concerned with how you're going to do it and why you're taking that approach. Risk is the primary language of financiers and they care more about not losing money than potentially making money. Risk can be determined by your operating track record, experience of your team, your growth plan, the feasibility of your financial projections and if you're compliant with taxes and other regulations. This process isn't the simplest, but it doesn't have to be frustrating if you're properly prepared. The following page describes the most commonly requested documents.

- 💡 Pro Tip: To get help with preparing your financial statements or to update your TCC check out the DBJ Voucher for Technical Assistance Program listed under "Additional Resources" in this guide.



Company Overview and Growth Strategy: A financier will need to understand what your business is and how it will grow. Earlier in this guide you documented your business, take that document and format it so it can be shared. This can be done as a business plan, pitch deck, business model canvas, or a combination of those documents. When sharing how you grow, document strengths and weaknesses - typically your approach is your strength and the weakness is what would prevent you from achieving your targets.

Management Team Overview and CVs: A company is only as good as its team. Collect the latest CVs for all your managers and executives and create a summary document outlining how long the team has worked together. This will demonstrate that the company has a capable team to execute the growth plan. Where your growth plan requires new hires, outline those positions as vacant in an Org Chart. Ensure the salaries for the vacant positions are included in your cash flow projections.

Financial Projections: So far we've focused on cash flow projections, but to support them you will also need the following:

- Projected profit and loss statement for 3 years
- Projected balance sheet for 3 years
- Projected cash flow for 3 years

[Make sure these documents are properly correlated and include the preparation method].

- Historical Financials (audited if possible). Past performance is not indicative of future financial performance, however historical financials can demonstrate how the company has operated in the past. For large value transactions these will need to be audited. Auditing your financial statements should be something completed at least every other year. A financial audit adds credibility to the accuracy and completeness of your financial statements. You should have at least the last two years of the financial statements audited.

Compliance records: Good compliance is a strong indicator of trustworthiness. If you can remain compliant with the government and other regulatory agencies then you're likely to maintain good business relationships overall. The most critical document is a valid tax compliance certificate, however if you're regulated in other ways such as a tourism industry operator or some other trade association then other documents may be required.

Governance documents: As a registered company there are documents that govern the daily operations. Financiers are interested in reviewing these to understand which entities own the company, how governance is managed, who the directors are and if the board has approved pursuing financing. Here's a list of commonly requested documents which you should have internally or with the Companies Office:

- Articles of Incorporation (most recent) - Available from Companies Office
- List of Company directors - Available from Companies Office
- Frequency of board meetings (If Applicable) - Provided by company secretary
- Copy of board resolution authorising team to pursue external financing - Provided by company secretary
- Shareholder agreements - Typically only required for equity financing

Understanding The Process

After preparing all your documents to apply for financing, there will be multiple forms of reviews, possibly additional questions and clarifications and possible redirection to more appropriate funding methods.

Funding also takes longer than most people think. Typically you will want to begin your fundraising preparation and application a year before you need the funds.

Equity Funding Process (3-12 Months)

- Online (website) or direct application (via email) for funding
- Junior associate reviews documents and evaluates opportunity
- If aligned it's shared with a more senior associate and meeting scheduled to discuss
- Initial terms are discussed and agreed, term sheet created
- Term sheet is presented to the firm's investment committee
- If the investment committee agrees then deep due diligence begins
- Once due diligence is completed, term sheets and supporting documents signed
- Funds disbursed as according to term sheet.

Debt Funding Process (2 Weeks to 12 Months)

- Online (website) or direct application (in branch) for funding
- Banking associate reviews documents to ensure all required information is gathered
- Banking associate meets with business operator to complete application process
- Application submitted to credit adjudication team
- If feasible, initial terms are discussed and agreed, approval document created
- If business operator agrees to terms then letter of undertaking signed
- Loan disbursed according to loan terms.

Things to note:

- Your initial point of contact is a sales person, no matter their professional title. It's in their interest to lend you money because it's how they earn commission. If you make their job easier they will make your application easier.
- Because your first contact is with a salesperson, you need to know what you want, what you're willing to accept and how to negotiate for it. Get the best terms possible, always ask for the best rates.
- The process is very manual with multiple stakeholders involved. It's often necessary to follow up frequently so an application doesn't get lost on someone's desk.
- When being declined it's a sign of three scenarios – (1) Not the right financier for your business; (2) You didn't communicate the value of the opportunity well; (3) It's an infeasible financing opportunity.

Alternative Financing Approaches

In every business, cash flow is king. Seeking financing is just one way to augment your business' cash flow. Fundamentally you can improve your cash flow by (a) utilising pre-payments, (b) increasing your margins, (c) increasing your inventory turnover ratio, (d) reducing your cash flow cycle and (e) increasing your revenue.

(a) Pre-Payments

A pre-payment is when a customer provides a payment before goods or services are delivered. Here are some practical examples of pre-payment:

1. Invoicing for a billing period at the beginning of the cycle. Let's say you provide a monthly recurring invoice for services to be delivered between the 1st and 30th of the month. Invoice for that at the beginning of the month so you receive payment before you incur the costs of providing that service.
2. Getting a deposit and milestone billing. If you're completing a large project or order, then request a deposit for mobilisation and have clear terms that trigger the next invoice. This will allow you to always have cash on hand to provide those products and services.
3. Pre-orders - If you're releasing a new product or service, allow customers to reserve their space in line and get first access by pre-ordering. This will help you gauge the demand for the product or service and also provide the capital up front to provide that product or service. Hotels and tour companies commonly benefit from pre-payments as guests pay for their experience in advance, however the same can be applied to physical goods. Crowd funding is also a form of pre-ordering.
4. Monthly retainers - if you're a service based company and consistently provide value to specific customers, you can request a retainer to guarantee your availability monthly. For example Company A purchases from Company B monthly, each month Company B can only cater to a specific amount of customers. Company A would be willing to pay company B a flat fee per month to ensure availability of resources to meet their monthly needs - even if they don't use all the resources in that period. This may also be in the form of a blanket purchase order or long term service level agreement.

(b) Increasing Your Margins

Often times operators don't realise the correlation between gross margins and profitability. By making small changes in pricing you can dramatically increase your profits and cash flow. Here are some practical ways to test and improve your margins. To get started, collect the following information:

- Annual Revenue
- Average invoice amount
- Gross Margin % = (revenue - cost of sale)/revenue
- Net Margin % = (Revenue - cost of sale - all other operating expenses)/Revenue

If you sell a product for $90 and generate a 1% net margin, ($90X1%), then you will have $0.90 in the bank to reinvest in the company. However that same product being sold for $91 would generate $1.90 in profit, or 211% more profit. Why? Because your expenses didn't increase but your profit margin did. Every $1 you make past your break even point will result in increased profit and more cash to re-invest in the business. Here are some quick tips to increasing your margins:

- Rounding up your invoice figures - if your pricing regularly creates invoices that end in $98 then or abstract figures, try to simplify it to end in the nearest dollar or 10 dollars. I.e. 100 vs. 98, or 400 instead of 390.
- Reducing costs - every dollar saved from your costs is going to increase your profitability. Just remember not to be penny wise and pound foolish. Sometimes it's better to spend more! Like buying in bulk.
- Increasing your average sale - The effort it takes to complete a sale is significant, you can become much more profitable if you can increase the value of each sale. Find ways to up-sell your customers by adding on items. For example, gas stations make way more money from their convenience stores than they do selling gas. Get creative by offering things that will improve your customer's life, for a small extra fee.

(c) Increasing Your Inventory Turnover Ratio

If your business sells products then you have inventory. The best way to understand inventory turnover ratio is to compare how long it takes you to sell 10 products. If it takes you a month to sell 10 products and each product costs $100 then you make $1000 in the month. If you sold those same 10 products in a day, and re-stocked, then you could earn $30,000 in a month. However if you had to keep 300 products in stock all the time, it would not be as profitable as quickly selling 10. There's a fine balance to maintain just enough stock to maximise profitability. That balance is making sure you can sell products in just the right time it takes to re-stock.

(d) Reducing Your Cash Flow Cycle

You're now on the path to becoming a cash flow wiz! Your cash flow cycle is the time it takes, in days, for a dollar you spend in the business to be returned to the business. Here are some simple ways to help improve the cycle:

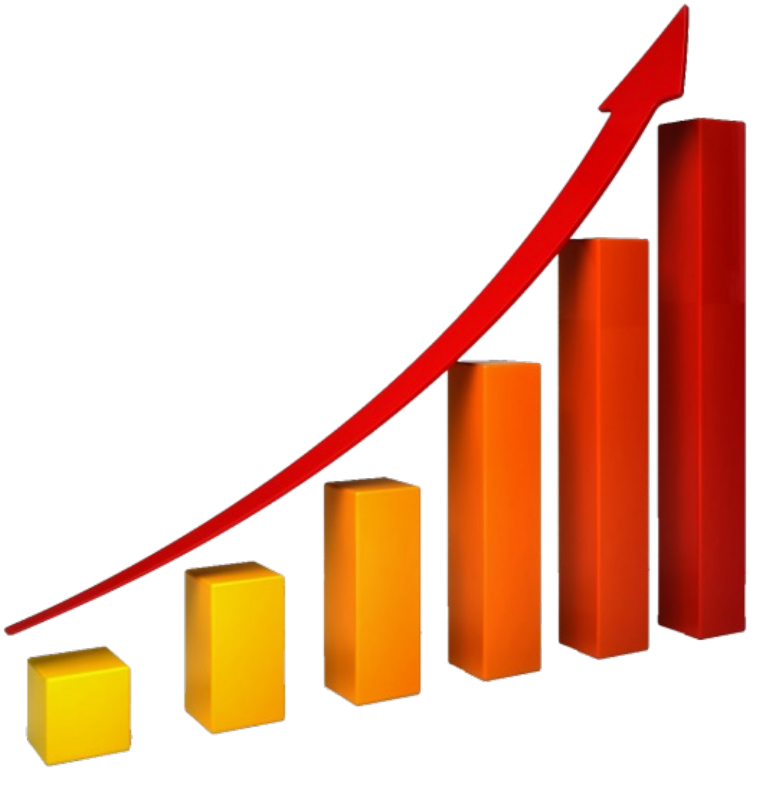
- Get deposits and pre-payments where possible.
- Change your billing cycle to bill up front, rather than after products or services have been provided.
- Get longer payment terms from your vendors - ask for 30 or more days in credit.
- Offer pre-payment credits to customers with longer credit terms. If you offer 30 days credit, offer a 1% discount on their next order if they pay before the invoice is due. You save on finance costs and your customer also saves while incentivising them to spend more with you.
- For vendors who don't offer you credit, use credit cards. Leveraging credit cards are fine once you pay on time, it can give you interest free credit. For example if you credit card statement is run on the 5th of the month and you make a purchase on the 6th, that payment won't be due until the 25th of the following month - almost 50 days credit!

(e) Increasing Your Revenue

The simplest way to improving your cash flow is to increase sales. Many business operators think they need external funding to re-invest in the business and scale but marginal sales improvements can provide the cash needed to fund growth initiatives. Consider the following before seeking external financing:

- Hiring more sales people.
- Incentivising increased sales - higher commissions if you exceed targets, bonuses etc.
- Referrals - this could be for customers or team members, give them a commission for referring new customers.
- Improve customer experience to drive recurring revenue.
- Customer relationship management - check in with customers who don't order as regularly. Make offers to customers who haven't purchased in a while to make a new purchase.
- Create new marketing offers, get creative. For example, a restaurant that wants to increase sales can offer a carpooling discount - come with 3 or more people in a vehicle and get % off. It brings more people to the table - literally and they will spend longer and spend more because they're with friends.
- Don't provide immediate discounts. For example, buy now and get 10% off your next purchase. This creates instant demand for your product but incentivises a customer to return because they have a coupon.
- Invest in marketing - it's not an expense if it works. Think of marketing as a revenue driver and pay keen attention to its efficacy.

By combining these practices and blending your sources of cash flow, you should be able to sustainably scale your business and continue to improve your customers' lives.



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October 2022

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