1. What is capital and why do I need it?

2. How do I know if I need capital and how much will I need?

3. Where do I get capital?

4. Where can I get grants and should I pursue them?

5. What is debt funding and how does it work?

6. What are the different types of loans and how do I get them?

7. What is the difference between microfinance and commercial loans?

8. What does the bank look at when deciding to make a loan?

9. What is collateral?

10. What is equity funding and how does it work?

11. Why would someone else invest in my business?

12. Should I ask for investments from my friends and family?

13. What are the kinds of investors and how do they work?

14. How do I find investors?

15. How do I negotiate the terms of getting capital?

16. How do I maintain a good relationship with lenders or investors?

17. How do I manage my own personal investment in my business?

18. How much does it cost in effort and funds to find capital?

19. What is a partnership and should I take one?

1.
What is capital and why do I need it?

The Basics

Capital is the money used for development or investment in your business. Depending on what you use the money for, it can be called different things:

Startup capital is the money you will need to start your business, including what you will need to pay all of your bills until your sales are high enough to do so.

Working capital is the money needed to make purchases/run your business before your customers have paid you. Every business must have sufficient working capital in order to stay alive, although the amounts can vary depending on the type of business. Companies that hold large inventories, have a long production process or have high dollar customers that pay on credit will need much larger working capital reserves.

Growth capital is the money needed to help a company achieve profitability after it has already gained a certain amount of traction. This could be additional funding to fully develop product features, to grow a team or to scale marketing efforts.

Expansion capital is the money needed to expand a business that is already profitable. Expansion can happen when you open another location, develop a new product / service, or automate your current processes. This amount is usually invested all at once, and adds to the basis for calculating return on investment for you and other investors.

Whether it comes from you, your family and friends, a bank or investor, or your initial customers, the most important thing to remember about capital is that it is expected to return more value back than it costs in the first place.

Understanding what any investment you make (capital, time, or energy) will do for your business AND for the person who invests it is not only crucial to successfully getting capital, but also essential for running your business.

Tell Me More

Startup capital is one of the toughest to obtain from outside sources, because there is significant risk involved. If you choose to fund your startup on your own, though, it may take you several months or even years to save enough of your funds to get started. Therefore, it is crucial to have a business plan and financial data that shows your business can make a profit quickly after the startup funds are invested. The biggest question asked for startup capital is: "Is this a profitable business model, and how long will it take to get there?"

A few creative ways to get startup capital include:

- Pre-selling your product to generate enough capital to do your initial production run. Once you deliver the pre-sold products, every other product you sell helps you build a working capital cushion and/or invest back into your business.
- Making your first employees "partners" in your business, so that you do not have to pay them or may have to pay them less in cash for the work they provide.
- Finding an initial customer who needs the type of solution you want to create, and having them pay for the solution development in exchange for an exclusive right to use the solution for a period of time.
- Basically, anything you can do to get your product or service in the hands of the people who would pay you for it before it is fully ready.

For example, Wahida wishes to start a Facebook store for delivery of party wear to women in the main cities of Afghanistan. She has contracted a wholesaler who brings clothes from India. She needed startup capital to order a few dresses to showcase on her Facebook shop. She did two things. First, she convinced the wholesaler to give her one month after receiving clothes before she had to make her payments. Second, she convinced one bride in Kabul and two in Herat to pay her in advance for their wedding dresses. This way, she managed to receive some startup capital from her customers while buying some time to stock dresses for her store.

Working capital usually comes in the form of internal savings, meaning that as your customers pay you, you deposit a portion of the revenues into a working capital account. This amount is set aside from your initial investment or from savings, although lines of credit can be set up specifically for working capital once your business has enough operating history. Some lenders may offer working capital loans, but these may have high interest rates and other fees. If possible, building your own working capital "reserve" or 2-3 months' worth of expenses is best. Companies that have larger working capital needs (because of inventory or large investments necessary to grow) will probably need to borrow, using their inventory or equipment as collateral – in which case this funding is no longer working capital, it may be growth or expansion capital. The biggest question asked for working capital is: "Are you able to pay it back in a short 3-6 month period?"

Growth capital can be obtained more easily from investors and/or lenders, because you should be generating revenues before you are ready to grow. Having a solid customer list, including repeat customers, is essential for obtaining this type of capital, as is a working product/service and a clear plan for growth. The good news is that having these things can also make borrowing an option, instead of looking exclusively to investors to fund your growth. The biggest question asked for growth capital is: "Are you sure that this is all the money you will need to cover all your costs?"

Expansion capital is also easier to obtain from investors and/or lenders, because your business is supporting itself financially. All of the elements listed to show traction for growth capital apply here. However, these outside funders may also look at your expansion plans as their own "startup", which means you will need to justify all of the costs and demonstrate the results you will be able to obtain clearly. The biggest question asked for expansion capital is: "Why can't you do this with your own money?"

Glossary Terms from this Section

Business Plan - A written document that describes how a business plans to reach their goals.

Expansion Capital - The money needed to expand a business that is already profitable.

Growth Capital - The money needed to help a company achieve profitability after it has already gained a certain amount of traction.

Investors - An individual or group who gives money with the expectation of financial return.

Profit - The amount that you make after you subtract your costs.

Startup Capital - The money you will need to start your business, including what you will need to pay all of your expenses.

Working Capital - The money needed to make purchases/run your business before your customers have paid you.

Line of credit – An agreement between a financial institution and a borrower that identifies a maximum amount of money that can be borrowed.

Business Model – A company's plan for how it will generate revenues and make a profit.

For More Information Related to this Topic See

- How do I know if I need capital and how much will I need? *3. Access to Finance*
- What are the kinds of investors and how do they work? *3. Access to Finance*
- Where do I get capital? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*

2.
How do I know if I need capital and how much will I need?

The Basics

Understanding if you need capital means thinking through how your business operates now or will operate once it opens.

You will need to identify how long you will be in business before you can start selling, how long it will take you to get your first customer and make your first sale, and how many sales you will need until your sales can cover all the costs of your business.

Startup businesses need startup capital which is the money you will need to start your business, including what you will need to pay all of your expenses.

All businesses need some working capital – it is a cushion for when your customers pay later than expected or when sales are slower than expected.

The amount of working capital you need may be scary because it is big. You do not have to have all of this capital on the first day. By identifying the cash needed to achieve a specific result now, you not only reduce your immediate cash need, but you have a chance to test out your theories of how your business will go before committing more money to it.

The key element of raising capital is to be searching early enough. If you think you will need a lot of capital in the coming year, start looking now.

Tell Me More

Every business needs capital. Some businesses are able to obtain the capital they need from their customers, particularly as those businesses grow. The price that the customers pay covers not only the cost of making or providing the service, but also all of the costs of running the business and the profit.

As a business matures, it may keep the profits inside the business and reinvest them. Sometimes, though, businesses are not able to keep enough profit to cover the costs of major changes, such as moving from manual to automated production, hiring significant additional staff or launching a massive marketing campaign. Or, because a business is new, it does not have enough customers to generate any profit at all, and is still spending more each month than it sells.

These are the most common cases where capital needs to be found outside the business. To understand how much capital you will need, look at your cash budget. Your cash needs are the total of all the cash shortfalls you will have until your business breaks even (where sales are greater than or equal to expenses).

If you do not have a cash budget, you can use your operating budget as an estimate. Take the total of all your net losses (where sales are lower than expenses), then add any equipment (or other assets that are not included in your operating budget) you will have to purchase as well as 2-3 months of operating expenses. That will give you an idea of the amount of working capital you will need.

Identifying how much cash you need, when you need it, and what you will do with it is essential to successfully finding that capital. After all, would you loan money to someone who wasn't sure how your money would help their business grow? Or when they would need it?

Consider linking your capital needs to a specific investment so that you can identify the specific results you will get from that investment. For example, if you are planning to hire a new sales person, identify how many additional prospective customers that sales person can contact, and how many of those new prospects will become actual customers. Using an average purchase per customer, you can even estimate the additional sales that this new sales person will bring.

As example, Negina run a noodle company in Mazar-e-Sharif. Her business is new. She made a little profit last month, but she is very financially constrained. She decided to avoid hiring a sales person for her noodle company because she realized the additional sales of 50 cartons per month wouldn't justify the person's salary. Instead, she asked one of her existing employees to dedicate 1 hour per day to reach out to new potential customers.

Compare the results of the investment (in this case, the new sales) to the cost (the annual salary plus employer charges and other costs of the new sales person plus any interest or fees for borrowing the funds to hire them). As long as you are getting a result that is worth more than your investment, it makes sense to find capital to do that.

Use this data to convince yourself first and foremost. After all, if you are going to ask others to invest in your business, you need to be confident that you can achieve the results you are showing. Look at the things you have invested in and identify which of your investments were successful and which were not. Evaluating your past decisions in this way will give you more data and more confidence.

Glossary Terms from this Section

Cash Budget - An estimation of your cash inflow and outflow of your business.

Operating Budget - An estimate of your operating costs and forecasted income over a period of time.

Operating Expenses - Variable costs that fluctuate in price often and directly affect the price of your product.

Profit – Any positive amount of money left over after subtracting expenses from revenue (income).

Startup Capital - The money you will need to start your business, including what you will need to pay all of your expenses.

Working Capital - The money needed to make purchases/run your business before your customers have paid you.

For More Information Related to this Topic See

- What is capital and why do I need it? *3. Access to Finance*
- Where do I get capital? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*

Additional Tools Available

Start Up Costs and Growth Capital Worksheet

3.
Where do I get capital?

The Basics

Money can come from many specific individuals or groups, but generally falls into three categories:

1. The first category of money includes funds that come from within the business, their own personal funds, their families or grant programs. People sometimes call these kinds of funding “free money” because the entrepreneur is not required to pay any interest or fees, and is not required to give up any part of their company to get it. However, this “free” money is never really free – particularly when you look at the time it may take to obtain it.

2. Getting this kind of funding can be a quick process if you find the money within your business or use your own personal funds, because you control when those things happen. However, getting funding from family and friends can take longer, and sometimes as long as getting equity investments from someone you do not know. Grants can take up to a year, and often have specific application dates so that they are not available year-round.

   Debt, meaning loans or credit arrangements, are funds that you borrow from someone today, and which you must pay back over time, usually with interest or fees. The challenge with borrowing is that you must be able to start making the repayment in a very short time frame. Finding funding by borrowing can take 2-6 months, assuming that you are a good candidate for it. It is more time consuming to borrow from banks than informal lenders. Requirements of banks are also stricter - i.e. you have to provide collateral as a guarantee that you will repay the loan.

3. Equity, meaning forming partnerships or taking on investors, means that someone invests in your business today, with no set method of repayment. Instead of knowing when they will be repaid (like a loan), these equity investors are co-owners of your business, and will share in the profits and any sales proceeds from your business.

When it comes to funding, there are two rules:

1. Look for funding that is a good fit for you, otherwise, you are wasting your time.
2. Start your search long before you actually need the funding because it can take a long time and running out of money puts you in a very difficult negotiating position.

Tell Me More

Convincing someone else takes more time than making a decision to do something yourself. That does not mean you should just invest your own money all the time. In order of importance, here is where to look for money before talking to banks or investors.

First, look in your own business to see if you have the needed capital by:

- Increasing revenues by raising prices or offering more high margin products to your existing customers,
- Decreasing expenses by carefully analyzing the return you are getting from your current expenses. Knowing where you can save money is as good as making more.
- Improving cash flow by ensuring your customers pay you on time or even modifying your payment terms to benefit your business. Getting deposits or working on retainer may help solve your cash flow problem.

Second, look in your own pocket and ask yourself whether:

- You believe that your business is a good investment.
- You can personally afford to invest more in your business right now.

One easy test for deciding if your business is as good investment is to ask yourself whether you would give a family member or friend the money to do what you are planning to do. If you wouldn't invest with someone you already trust in the same situation, it may not be a good idea for you to continue investing in your own business. And you should re-evaluate your business model before you look for any additional funding.

Last, look at other sources of "free" money (notably grants and friends / family) and determine:

- Whether you have a decent chance of getting it, and
- If you really want it, because often "free" money comes with other obligations or extra work

Applying for grants can take a significant amount of time, and the delay before you know if you have been selected can be 3-6 months. In addition, there may be significant reporting requirements related to the acceptance of the grant money, or restrictions on what the funds can be used for. Be sure that you understand these components of the program before you spend time and energy applying.

Likewise, receiving money from friends and family has both advantages and drawbacks. While a friend or family member may say yes quickly to investing in your business, they may take a while to give you the cash – and it can be difficult to remind them the way you would a lender or investor who had a contractual obligation to finance your business. In addition, the risk of having these types of investors is not simply to their investment, it is also a risk for your relationship with them.

Glossary Terms from this Section

Cash Flow - The total amount of money coming in and out of a business.

Equity Investment - People who invest money into your business in exchange for part ownership.

Expenses - Money paid out of the business to pay for an item or service.

Investors - An individual or group who gives money with the expectation of financial return.

Revenue - Money coming into the business usually from the sale of goods or services.

For More Information Related to this Topic See

- What is capital and why do I need it? *3. Access to Finance*
- Where can I get grants and should I pursue them? *3. Access to Finance*
- What are the kinds of investors and how do they work? *3. Access to Finance*
- Should I ask for investments from my friends and family? *3. Access to Finance*

Additional Tools Available

Common Funding Sources in AFG

Financing Options Summary

4.
Where can I get grants and should I pursue them?

The Basics

Grants are usually funded by governmental or non-governmental organizations that want to effect social change. Often, they are focused on a specific industry (such as agriculture), on finding a solution to a particular problem (such as drought, poverty, unemployment, etc.), or on assisting a specific demographic (such as returnees that wish to start a business).

Just because an organization provides grants does not mean they do not have requirements and expectations of you as the grant recipient. Because grants are usually funded by charitable donations and/or taxpayer funds, the granting organization must be very careful about who receives grants and how the funds are used.

This means that applying for a grant can be complicated, can take lots of time and energy, and your chances of receiving any specific grant can be relatively small depending on the qualifications of your business.

For this reason, it is crucial to identify very quickly:

- How closely you fit the grant's guidelines (the closer, the better), and
- Whether or not the funding you could receive will make a huge difference in your business.

One easy way to check the first element is to research the organization that is providing the grants. What are their motives, who are their donors, and what social change are they trying to effect? If you feel that you are clearly aligned with the organization's mission, then it might be worth exploring further. If not, do not waste your time.

When it comes to understanding the value of the grant for your business, simply compare the total amount of funding you need to the highest potential award you could obtain. If you need 500,000 AFN and the grant is only for 25,000 AFN it is probably not worth the time and energy you will use to apply for it. However, if you could obtain all the funding you need from one or two grants; it may be worthwhile to pursue grant funding.

Tell Me More

If you are sure that applying for a grant is a viable funding source for you, you will want to approach the process in much the same way you would any other request for investment. You will need to consider things like:

- Why is your business worthwhile, what is your business model and how will you grow? Just like any other investor, grantors will want to know that they are contributing to something sustainable and that you are planning to stick with your business for the long term.

- How much funding do you need, and what results will that funding generate for your business? Being very clear about what you will use the funds for is critical, particularly if the grant has restrictions on how the money can be used. Use your business plan and financials to show what kind of return you will get with their money (how many new customers will be served and vendors supported, how many people will be employed, how will your business change your life and your family's life?) Demonstrating the results you are expecting from the grant funding will also set you apart from most other applicants. Identifying the ways that your business will achieve some of the grantor's goals (see below) can make it easier for the grantor to say "yes".

- What return do you offer the grantor? This may include creating or saving jobs locally, allowing historically underserved groups to access services / products / employment, improving your own and your family's lives with financial security, or other social changes. You want to demonstrate not only that your business will be a success, but that it will achieve the objectives of the organization that is offering the grant. Showing the grantor how you will be an asset to their program and their organization will increase your chances of being selected.

- Make your application memorable. Since most grants received thousands of applications, it is critical that yours stands out. If you can create a short video or use images of your customers, employees, vendors, products, etc. to help the grantor see the reality of your business, this can be very helpful. The saying "a picture is worth a thousand words" is particularly applicable to applications with lots of text. However, don't think that the longer you make the application, the better it will be. Keep your application to the point and no longer than it needs to be.

- Do not let the grant writing process take over your business. Although you may want to have the "perfect" application, your chances are still slim. Many SME owners do not have the expertise to complete a professional grant application and hire a consultant to fill the application or write a proposal. If the business owner is applying for a grant from USAid, she may be asked to first complete a short concept note and then later submit a longer grant application. Sometimes the USAid staff will assist with the application phase. But regardless of the procedure, it is crucial to carefully monitor the amount of resources you invest into this process. It may be easiest to decide how many hours you will commit to researching, identifying and writing the grants you believe are your best bets. And once you have invested that amount of time, you submit the applications without looking back.

In Afghanistan, usually donor organizations provide grant funding to SMEs. But these opportunities may expire and new ones become available. You should be on the look and follow activities of granting organizations if you believe you will need grant funding going forward. Some of these organizations are United States Agency for Development (USAID) i.e. through Promote: Women in Economy program, Afghanistan Reconstruction Trust Fund (ARTF) i.e. through NATEJA project, CARD-F, World Bank Group, etc.

Many business owners invest too many resources into money like grants – and as a result, they do not focus on getting customers, managing their vendors and employees, or on developing their products or services. Building your business is your top priority, and the more money you can find within your business, the less money you must find from somewhere else.

Unless you are convinced that you are an ideal candidate and you know that the grant funding is large enough to justify the time required to apply, grants may not be the right funding method for you.

For example, when Farzana started her health center for mothers where she gave advice to pregnant women and mothers, she needed a few pieces of medical equipment. She had enough to start her business and purchase necessary furniture, computers, and some basic medical equipment. After a while, she needed more equipment. She applied for a grant from a donor organization, but her application was initially rejected. She asked for feedback and realized she had not given sufficient information about the results of her work and the benefits of advice to the health of mothers. After a re-application, she received a grant of about 1,000,000 AFN to buy equipment. The donor organization strictly ensured that Farzana buys the intended equipment and does not use the funds for another purpose. It was a good opportunity for Farzana, but it took her about 5 months to complete the process.

Glossary Terms from this Section

Charitable Donations - When a person/group gifts money, goods, or services to an organization.

Demographic - A particular part of a population.

Grantor - A person or institution that gives out a sum of money with no contract of repayment.

Grants - A sum of money that is given or gifted to an individual or organization by another organization with no contract of repayment.

Investors - An individual or group who gives money with the expectation of financial return.

For More Information Related to this Topic See

- How do I know if I need capital and how much will I need? *3. Access to Finance*
- Where do I get capital? *3. Access to Finance*
- What are the kinds of investors and how do they work? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*

Additional Tools Available

Common Funding Sources in AFG

5.
What is debt funding and how does it work?

The Basics

Debt funding means borrowing money from someone today with a specific plan for repaying it over time. The specific repayment plan is what makes debt different from equity, and what reduces the risk for the lender.

Generally, risk and reward go hand in hand – the riskier something is, the higher the reward needs to be in order for someone to do that risky thing. In other words, the riskier something is, the more the person taking the risk needs to get "paid" to convince them to do that thing, even if their reward isn't money.

For example, if you have a friend who is very reliable, you would be more willing to make plans with her than with a friend who is unreliable. The time and energy you invest making plans with your reliable friend is likely to result in an enjoyable time together. You risk spending the same time and energy making plans with someone who is unreliable and have them cancel at the last minute. You may be less likely to make plans at all with the unreliable friend because you don't want to risk wasting your time.

Lenders and investors have this same perspective on your business. They want to understand the risks and the rewards that you are offering them to decide if you are a good fit for them.

Like individuals, every investor is unique, but they do fall into broad categories based on their view of risk and rewards. Lenders (those who offer debt funding) are usually much more focused on reducing their risk, meaning that they are willing to accept a lower reward than an investor might expect.

A big part of reducing their risk is having the specific repayment plan, so that they get a portion of their investment back each month. This is why every loan document should contain a written repayment schedule, so that you can verify (before signing) what your monthly payments are.

Another important component of reducing risk is the use of collateral and/or personal guarantees. This assures the lender that if you are not able to make your monthly payments, they have an item of value (the collateral) that they can sell to recover what is owed, or they have someone else (the person making the guarantee) who will step in to pay your debt.

This also means that if you can't demonstrate your ability to repay, or if you do not have collateral to offer, debt financing may not be a good option for your business.

Tell Me More

Many lenders are banks or other institutions (microfinance lenders, non-banking financial institutions, etc.) that make loans using other people's money. This is the main reason there are so many steps and processes associated with borrowing. The bank needs to be sure that it is keeping its customers' money safe.

To protect both the bank's customers and borrowers, there are also regulations about the kinds of transactions that lenders can enter into. These regulations may limit the amount of interest or fees that a bank can charge, but may also prohibit the bank from making loans to certain industries or categories of businesses that are deemed too risky.

If you are looking for debt funding, it is best to explore each of the potential lenders' underwriting criteria (the things you will need to do to qualify for a loan) before you make an appointment to talk to a banker. Identifying 2-3 lenders that seem to be the best fit for you will save you time and energy, and will show the lender that you are taking your funding search seriously.

Most loans from institutions are very structured and fall into two categories:

- Secured debt, meaning that the loan has collateral to secure it, or
- Unsecured debt, meaning that the loan is made without collateral – however, in this case, personal guarantees may be required. The amount of unsecured is usually very small and primarily fall into microfinance category.

Most institutional loans in Afghanistan are formal and secured with specific conditions and requirements. Knowing which type of debt you are looking for can help you select your lender, and again demonstrate your seriousness to them. The common set of lending requirements that Banks set for SMEs include:

1. A valid business license from a recognized government authority
2. Currently active status of the business and ensure the company is operating for at least two years
3. A convincing business or investment plan that justifies the requested loan amount and shows strong market demand for the products or services
4. Collateral in the form of Sharia (legal & officially registered with the government) property deed representing immovable asset i.e. real estate with a building, with a value of 200% of the requested loan amount
5. Additional guarantee in the form of movable property such as working capital, inventory, fixed assets, etc.
6. At least one external financial guarantor, and in case of loans above 100,000 USD, two corporate guarantorsGood financial performance i.e. revenue, profit, inventory, etc. as shown in financial statements

The process of getting a loan often follows these steps:

1. You look for brochures or other sources of information, i.e. websites, to find about potential lenders with a product for SMEs
2. You speak with a banker or representative to explain your business plan and funding needs.
3. If they see one of their programs that fits your needs, you complete and submit an application.
4. You complete the loan application and provide financial information about your business such as financial statements for two years and information about your revenue and profitability.
5. The lender reviews your application and asks questions or requests additional data. This process is called underwriting. The more complete your initial application, the quicker the underwriting goes.
6. The lender determines whether your application is worthy of approval. If so, the lender will make a visit of your company and complete a due diligence process.
7. Once all the information is complete, the lender either rejects your application (meaning they won't loan you the money), or they make you an offer.
8. If you receive an offer, you can decide whether you'd like to work with this lender or not. There may be room to negotiate some of the key terms of the loan, such as the annual interest rate or fees, the start date/day of the month of repayments, repayment schedule, and any fees associated with the loan. The legal aspects of the documents (jurisdiction, right to foreclose, etc.), as well as any liens against the collateral are usually non-negotiable.
9. If you and the lender agree on the loan terms, you will receive loan documents that should clearly describe the key terms. You should also receive a detailed repayment schedule that shows each month's payment amount, how much of the payment is made for interest and principal, and the remaining principal balance after that payment.
10. After signing the loan documents (a process called closing), you could receive your funds in 5-10 business days. You need to verify with your lender and the loan documents when funding will occur, as some lenders have a longer delay between closing and funding.
11. Be sure that you have all of the information related to your repayments, including the monthly amount, the address or banking information for making the payment and the due date. Some banks have the ability to

create an automated payment from your bank account to the lender based on a set schedule; this is the best way to ensure that you do not miss a payment. If you do not have a way to automate the payment, be sure to put a reminder in your calendar for 3-5 business days before the payment is due so that you do not forget to make it.

Once your loan is closed and funded, do not ignore your banker. They will usually ask for quarterly or annual written reports on your company for their records, but staying in touch with them more often can be very useful, especially if things do not work out as you expected and you need to ask for an extension or delay a payment.

Glossary Terms from this Section

Business Plan - A written document that describes how a business plans to reach their goals.

Collateral - Something of value you own that will be taken if the loan is not paid back.

Debt Funding - Financing your business by taking money and paying it back in the future with interest.

Equity - The value of shares or ownership of a part of a company.

Investors - An individual or group who gives money with the expectation of financial return.

Lien - The right to keep a property belonging to another until the loan is repaid.

Personal Guarantees - An individual's legal promise to be responsible and repay any debt that the business cannot repay.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- What is equity funding and how does it work? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- What does the bank look at when deciding to make a loan? *3. Access to Finance*
- What are the different types of loans and how do I get them? *3. Access to Finance*
- What is collateral? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

6.
What are the different types of loans and how do I get them?

The Basics

There are many different types of loans with various conditions associated with them. Some common loan types include:

- Secured
- Unsecured
- Cash advance
- Factoring

Secured loans are those that are "secured" by collateral, meaning that the lender also has additional security for being repaid. Examples of secured loans are mortgages on buildings, property and equipment liens, and term loans. Because of the security associated with the loan, this type of loan usually has a lower interest rate but may have higher fees associated with it.

Unsecured loans are those that have no security backing them, meaning that they are riskier for the lender. Examples of unsecured loans are credit cards, an overdraft facility, and lines of credit. Due to the higher risk, these types of loans usually have higher interest rates or fees.

Cash advance loans are designed to be extremely short-term borrowing, and as such have high interest rates and fees. Most often, the lender will require daily repayments and may even require you to allow them to access to your bank account.

Factoring (also called contract financing in certain cases) is a unique method for borrowing funds that works for companies who have large amounts invoiced to credit-worthy companies. Because larger companies often pay slowly, this can create a major cash issue for small companies that sell to them. In a factoring arrangement, the "lender" will either make an advance against a company's existing invoices or purchase them outright at a discounted price. The company gets cash today, and the "lender" gets paid once the original customer pays. Factoring can be a good way to get cash into your business sooner, but needs to be carefully evaluated to ensure it is right for you.

Tell Me More

Secured loans

These types of loans can come from either banks or from equipment providers who can easily understand the value of the security (collateral) that you are providing. Interest rates on secured loans can range between 7-18% but there are usually additional fees related to the collateral. Additional costs may also be incurred because of maintenance, insurance and other safety requirements on the collateral. One common cost is that of registering the collateral in the government's relevant courts and transferring the ownership to the lender until you repay the loan.

Secured loans require additional legal documents, so be sure that you get appropriate legal advice throughout this process. And do not forget that using an asset as collateral limits your ability to sell the asset or use it as collateral for other loans. Looking for a secured loan can be a great solution for a specific piece of equipment that you know you will need in your business for at least as long as the term of the loan. The majority of loans in Afghanistan are secured and require collateral.

A common type of secured loan in Afghanistan is a Term loan. A term loan is a loan from a bank for a set amount of money that has a specific schedule for repayment. Term loans may have a fixed or floating interest rate. Small businesses often use term loans to pay for things like equipment, property, or working capital.

Unsecured loans
These types of loans are offered by banks, but informal lenders also fall in this category. Since these loans require less documentation, they can be obtained more quickly. Be sure that you get legal advice on the documents you do sign, since there are fewer standards and little regulation on unsecured loans. Beware, the legal documents may be included in the application, and can be called "terms and conditions" or something similar. Unsecured loans are least common in Afghanistan and are mostly provided by microfinance institutions. When you borrow from family and friends, that's also a form of unsecured loan as they will not require collateral.

Interest rates on unsecured loans can range from 15-20%, and they may have annual fees associated with them regardless of the amount you borrow. For example, lines of credit with major banks can have a 0.25% annual fee on the total available balance, in addition to the other fees and the interest rate.

Repayment on unsecured loans are still at the discretion of the borrower, meaning that you must make the payments yourself, or face late fees and possible penalties.

Line of Credit
A line of credit is an agreement between a financial institution and a borrower that identifies a maximum amount of money that can be borrowed. These funds can be accessed as needed as long as the borrower doesn't exceed the limit and also meets any other requirements, such as making payments on time.

Factoring
Factoring can be a longer-term method for managing your cash flow from customers, assuming that you have a high enough profit margin to cover the costs of factoring. Factoring can cost between7 and 10% of the invoice amount, with the cost per invoice decreasing as the total monetary volume of invoices and the quality of the customers' credit increases. Having fewer, large invoices (especially to a single customer) instead of many small invoices can also decrease the cost of factoring.

Factoring can be a great solution for small companies that work with large customers that are slow to pay. Although factoring isn't technically a loan, it is a credit arrangement that can benefit certain types of businesses. However, like loans, it is imperative to review all the documentation related to this agreement.

Other considerations include how the factoring company will communicate with you, how they will treat your customers during the collection process (especially if they are your largest customer) and how any significant delays will impact your cash flow. Some factoring companies may only select all your best creditors and leave you with the most problematic accounts. Obviously, you do not want to completely lose control of the collections process, because you need to be able to keep your customer happy while not continue deliveries if they haven't paid.

A good number of banks in Afghanistan now offer SME Loans that specifically tailored to the needs of SMEs. The exact structure of each loan type depends on the strategy and procedures of each bank, but usually these SME Loans have easier terms and conditions with limited due diligence.

Glossary Terms from this Section

Collateral - Something of value you own that will be taken if the loan is not paid back.

Lender - A person or organization who offers others an amount of money to use for a fee.

Lien - The right to keep a property belonging to another until the loan is repaid.

Line of credit – An agreement between a financial institution and a borrower that identifies a maximum amount of money that can be borrowed.

For More Information Related to this Topic See

- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What is the difference between microfinance and commercial loans? *3. Access to Finance*
- What does the bank look at when deciding to make a loan? *3. Access to Finance*
- What is collateral? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

7.
What is the difference between microfinance and commercial loans?

The Basics

Commercial loans are usually offered by banks or credit unions and are designed to meet the borrowing needs of the bank's business customers while also providing an attractive return on the bank's investment. Afghanistan Central Bank (known as Da Afghanistan Bank) regulates the banking sector and sets rules for the banks' lending activities. Banks provide loans of various sizes. The following is a common classification that banks use:

- Micro Loans: 500,000 AFN or less
- Small Loans: 500,000 AFN up to 5 million AFN
- Medium Loans: 5 million to 15 million AFN

Because the bank is making these loans with its depositors' funds, there are usually restrictions on the amounts and types of commercial loans that can be made by each bank.

Lenders also have their own internal criteria for deciding who qualifies for a commercial loan, which can vary from institution to institution.

Commercial loans are generally available to companies that have been operating for at least two years, and have their business accounts with the institution they are seeking to borrow from. It is not uncommon for commercial lenders to request collateral and a personal guarantee, especially for a high loan amount or for a first-time borrower.

Microfinance loans are generally designed with a humanitarian or economic focus. While they have similar structures to commercial loans, they are usually offered to borrowers who may not qualify for traditional loans for a variety of reasons, including:

- Little or no history in business
- Poor or no personal credit
- Lack of sufficient collateral / personal assets
- Small loan amounts
- Extended repayment periods

Tell Me More

If you are just starting your business, commercial loans are probably not a good fit for you as the qualification requirements may be too high. Some micro loans may be an option, but as with grants, you need to be sure that your probability of getting funded is high enough to justify the time and energy you will invest in applying before you do it.

Some organizations offering microfinance loans are:

- OXUS Afghanistan
- First Microfinance Bank (FMFB) Afghanistan
- FINCA
- Mutahid Development Finance Institution
- Islamic Investment and Finance Cooperatives (IIFC) Group

- Exchangerzone Microfinance
- Afghan Rural Finance Company (ARFC)
- Shelter For Life (SFL)
- Hand in Hand Afghanistan
- Aga Khan Foundation (AKF)
- Afghanistan Women Council (AWC)

Glossary Terms from this Section

Collateral - Something of value you own that will be taken if the loan is not paid back.

Lender - A person or organization who offers others an amount of money to use for a fee.

Microfinance Loans - Loans designed with a humanitarian or economic focus and are offered to people who may not qualify for a traditional loan.

Personal Guarantees - An individual's legal promise to be responsible and repay any debt that the business cannot repay.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What does the bank look at when deciding to make a loan? *3. Access to Finance*
- What are the types of different loans and how do I get them? *3. Access to Finance*
- What is collateral? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

8.
What does the bank look at when deciding to make a loan?

The Basics

There are many factors that banks look at when evaluating and deciding whether or not to make a loan to others. For a basic list of requirements, read “What is debt funding and how does it work?” of the toolkit.

When deciding to make a loan, lenders look at the following:

- **Personal versus business credit** - Who is borrowing the money? If you are borrowing for a new business, there may be very little information about your business, meaning that the loan could be quite risky for the bank.

- **Collateral and immovable property** – Banks need assurance that in case you or your business cannot repay a loan, they can recover their lent money. They will ask you for real estate that is in your or someone else’s name to secure their loan. The property is usually registered in the name of the bank in the relevant courts of Afghanistan and any liens taken back when you repay the loan.

- **Personal guarantee and personal assets** - Even if your business is officially borrowing the funds, you as the owner may be asked to provide a personal guarantee and/or pledge some of your personal assets as collateral. This is to reassure the bank that you will pay them back if your business cannot.

- **Loan amount and uses of funds** - How much are you borrowing, and what will you use it to achieve in your business? The clearer your plan for what you borrow and the results you will achieve, the easier it is for a banker to feel confident in your ability to pay back the loan.

- **Ability to pay back the debt** - Can your business generate enough cash to pay back the interest or fees and principal payments? This is a simple mathematical calculation that compares your monthly loan payment to the remaining cash from your business. Lenders will also want to know what happens if you lose a customer, or if your plans take longer than you expect.

- **Trust and relationship with the lender** - Do they know you, do you respect your commitments, are you a good business person? Especially if you are borrowing for the first time, lenders want to understand how risky their loan will be, so they look at you (as an individual) to decide if they can trust you.

Tell Me More

Because lenders are usually loaning someone else’s money, they have a lower tolerance for risk and are also subject to regulatory requirements of Da Afghanistan Bank for their loans. Risk and reward are inversely related, this means that the riskier they perceive your business to be, the higher the interest rate or fees they will charge to make a loan – if they decide to make one at all.

If you are considering getting a loan, think about what you can do to reduce the risk within your business. This can mean testing out new products or processes on a small scale before asking for a loan to expand them. Or it could mean gathering customer commitments for purchase before asking for a loan to purchase production equipment.

As you are preparing to talk to lenders, think about what could go wrong, and do your best to show them that you have a solution (or at least an idea of a solution) for that problem.

A bank is investing its depositors' funds in the loan it makes to you – and they owe it to their depositors to make sure they are using those funds wisely and not taking too high a level of risk. This means they need to be as sure as possible that the money they loan to you will be returned. This is the reason that many lenders have a long application with many questions about your past businesses, your experience in your current business and others. Banks in Afghanistan now check with Afghanistan Credit and Collateral Registry offices in Da Afghanistan Bank to learn more about credit history of a borrower. In some case, banks also conduct a reference check and talk to your previous lenders to understand your credit history better.

A personal guarantee is your commitment as an individual to be responsible for the debt of the company. This means that even if you have formed a separate legal entity, if the company cannot repay the debt, you agree to use your personal assets to do so.

Collateral is any asset that can be pledged to a lender to satisfy your debt if the company cannot repay the loan. Instead of you as an individual promising to pay, a collateral arrangement would actually give the lender the right to sell a specific asset (or more than one asset) if the loan was not repaid.

Additional factors that banks consider are your personal financial literacy and ability to lead your business, the accuracy and reliability of your book-keeping system, and your financial management skills. Banks require you to have good book-keeping system and present periodic financial statements that indicate the healthiness of your business.

Glossary Terms from this Section

Collateral - Something of value you own that will be taken if the loan is not paid back.

Lender - A person or organization who offers others an amount of money to use for a fee.

Personal Guarantees - An individual's legal promise to be responsible and repay any debt that the business cannot repay.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What is collateral? *3. Access to Finance*
-

Additional Tools Available

Approaching an Investor Checklist

9.
What is collateral?

The Basics

Collateral is an asset that you promise to a lender to reduce the risk of a loan they are making to you. In some cases, it is the asset that you are purchasing with the money that you are borrowing, like a car or a piece of equipment. In most cases in Afghanistan, collateral is a real estate property with a considerable value that can secure a loan with at least 200% collateral-to-loan-ratio.

An asset that has been pledged as collateral cannot be sold or otherwise disposed of unless the lender agrees. Usually, the lender will request that their rights be legally recorded with something like a lien.

Pledging collateral means promising that your lender can take that asset and sell it themselves if you are unable to pay them back. This allows the lender to feel more comfortable about loaning you the money, because they have something tangible that they can seize if you are unable to repay your loan.

Collateral is commonly required for new businesses, since the lender has no way of knowing whether your business will be able to repay the loan or not.

Assets that can be used as collateral include: equipment/vehicles, personal assets (home, factory buildings, vehicles)), existing customer invoices (if they are very large and your customers are companies with good credit) and inventories (where the goods are non-perishable).

Tell Me More

It is important to note that banks in Afghanistan only accept collateral that has a legal title deed (Sharia Qabala) and is officially registered in the government in your name. The legal title deed is thoroughly evaluated by the banks to ensure its authenticity and its ownership is given to the lending institution when you register your property as a collateral for a loan.

Another type of document is Customary Deed (Urfi Qabala) which is usually an informal written agreement between a seller and a buyer of property. This form of property is usually not accepted as collateral for SME loans, however, microfinance institutions might accept Customary Deeds as collateral too.

Pledging an asset as collateral is not a small matter. It limits your rights to use the asset, particularly if you want to sell it. In order to make sure that you pay your loan back, many lenders will hold the title (ownership) of the collateral until your debt has been paid in full.

When using an asset as collateral, you may also be restricted in what you can do with the asset. You will be required to use the asset strictly for your business, and may be required to perform preventative maintenance and keep insurance on the asset.

In some cases, you may also be prohibited from moving the equipment to another city or being used for certain activities that could be dangerous for the equipment.

Setting up the legal agreements for collateral can also require you to get legal advice. Be sure to get an attorney to review any legal documents related to the collateral agreement. When you borrow from a bank, it provides a legal person as the bank's representative to process the registration of your property in the relevant courts as collateral.

Even if you have purchased your asset with financing directly from the seller, the asset will still likely be held as collateral. If you are using seller financing to purchase an asset, be sure to have your attorney review all the legal documents associated with the financing.

Glossary Terms from this Section

Assets - Anything of value that your business owns.

Collateral - Something of value you own that will be taken if the loan is not paid back.

Lender - A person or organization who offers others an amount of money to use for a fee.

Lien - The right to keep a property belonging to another until the loan is repaid.

For More Information Related to this Topic See

- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What does the bank look at when deciding to make a loan? *3. Access to Finance*
- What are the different types of loans and how do I get them? *3. Access to Finance*

10.
What is equity funding and how does it work?

The Basics

Equity refers to the value of the ownership of any asset after all the debts are paid off. With equity funding, you are selling part of your business to an investor. You're giving up part of the ownership of your company in return for the funding. With most equity capital, you aren't required to pay back the money as you would with debt.

Ownership of the business means control of the business. By selling part of the ownership, you are giving up part of the control. Having control means having the right to make decisions about how the company is run. If you sell 50% of the ownership of your business to someone else, you are giving up 50% of the control. That investor would have an equal right to make decisions in the business, unless you have made an agreement otherwise.

When you give up part of your ownership, you are also giving up part of the value of your company. And this is not just the current value, but also the future value. As your business grows, the value of that slice of ownership that you sold will also grow. 50% of a business worth $100,000 is a lot less than 50% of a business worth $10 million. This is why equity capital is often said to be the most expensive kind of capital. You might be selling something today that could be worth a lot more in the future.

Investors take many different forms. You might have a single person who wishes to be an investor. This might even be a friend or family member. An individual may want to be a partner and have a say in the daily decisions of your business or they may allow you to run the company's routine operations but only share the profits.

Regardless of who an investor might be, it's absolutely critical that you create a clear agreement that explains what the investor expects for his or her money.

An entrepreneur may also have multiple investors. There are groups of people who work together to make investments. There are also organizations that exist only to make investments in promising companies. For most entrepreneurs who are in the early stages of their business, it's unlikely that they would find funding through these investing groups or organizations. It's more likely that they would have a relationship with an investor that they know, if any investor at all. Equity capital is usually a solution used by more mature businesses. Sometimes these agreements with investors bring more than money to the entrepreneur. An investor may also provide contacts and other resources. The best agreements will include both financial support and expertise to the business owner.

One of the most often overlooked aspects of taking equity investors is the fact that you will be working with this person for the life of your business. So even if they offer you a very attractive opportunity, be sure that you can work with them for the next 5-10 years.

Tell Me More

Getting equity investors means finding individuals or groups who will give you money today in exchange for partial ownership of your company. The advantage of equity funding is that you usually don't have to pay the money back. This can save your business cash in the short-term. Depending on the amount of funding you are looking for, the investor may require a larger share of your business. If you sell more than 50% of your business you may become a minority shareholder in your own company. This means that the investor has the right to make the decisions and will be the one who receive a bigger piece of your company's profits. Most entrepreneurs avoid selling off more than 49% of their companies to avoid this situation.

Risk and reward are related. The riskier something is, the higher the reward needs to be in order for someone to do that risky thing. Said another way, the riskier something is, the more the person taking the risk needs to get "paid" to convince them to do that thing, even if their reward isn't monetary.

Lenders and investors have this same perspective on your business. They want to understand the risks and the rewards that you are offering them to decide if you are a good fit for them.

Just like individuals, every investor is unique, but they do fall into broad categories based on their view of risk and rewards. Investors (those who offer equity funding) are usually much more focused on the potential for a big reward than on reducing their risk.

This is the reason that most equity investors will be focused on the potential of your business instead of where you are right now. They are taking a risk today on the chance that your company will grow bigger and more profitable in the future. If they think investing in you is very risky, they will likely ask for a larger ownership stake in your business.

It is important to note that, unlike lenders, equity investments are recently regulated in regard to their terms. The applicable Afghan laws, such as Insolvency Law and the Company Law set forth provisions that guide investment partnerships, but not always the laws can protect you from excessive interest rates and/or fees, so you must be very careful with not only the terms of your agreement, but with the agreements themselves.

Glossary Terms from this Section

Equity - the value of the ownership of any asset after all the debts are paid off.

Equity Investors - People who invest money into a company in exchange for part ownership.

Investors - An individual or group who gives money with the expectation of financial return.

Profit Distribution - The spreading of profits to different recipients like shareholder/owners.

Shareholder - The owner of shares in a company.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- Why would someone else invest in my business? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? 3. *Access to Finance*
- What is a partnership and should I take one? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

11.
Why would someone else invest in my business?

The Basics

The reason someone else would invest in your business is because they believe it will give them a reward they are looking for with an acceptable level of risk.

This may seem strange at first but think about how you make decisions. Imagine that you want to try a new product but are not sure whether it will provide the results you need. If the price is low, then you may try it. If the price is high, you may be more likely to wait or perhaps never purchase the new product.

In this case, you are comparing the risk of the product (how much it costs) to its reward (the ability to provide you with the desired results). If the price (risk) is low, then you are more likely to try the solution, even if you are not sure it will solve your problem (reward). However, if you had to invest more, you'd be more concerned about the likelihood of getting your reward.

When someone wants to invest in your business, you need to clearly identify what they believe the risk and reward to be. This will not only help you attract the right investors for you, but it can also open your eyes to areas of your business that need attention because they are (or are perceived as) risky.

Tell Me More

People will invest in your business for a few reasons:

- **Because they believe you can solve a problem they have** – these investors are called customers. They invest money and they want to receive a solution (product or service) to their problem as a return on their investment.

- **Because they believe in what you are doing and have a skill that you need** – these investors are called employees. They invest time and energy and want to receive payment and (possibly) benefits as a return on their investment.

- **Because they believe in your dream of business ownership and want to see you succeed** – these investors are called friends and family. They can invest time, energy and money, and they want to see your success and (perhaps) some financial compensation as a return on their investment.

- **Because they see your business as an attractive investment opportunity that will provide them with a financial return** – these investors are called business angels or venture capitalists. They invest money and they want to receive multiple times their investment back as a return.

- **Because they want to sell you their products** – these investors are called vendors. They may loan you some money to purchase their products, and they want to receive that money plus interest as a return.

- **Because they have an organizational goal to assist small businesses, develop new technologies or improve economic conditions in your area** – these investors are called grantors or philanthropists. They invest money (and sometimes time and energy), and they want to understand the impact that you and your business have on their particular goals. They expect information and communication with you as a return on their investment.

Two years ago, Fahima started a women's magazine and needed an initial investment to cover the costs of printing. She approached a wealth family friend and asked for investment. The investor asked about the readers of the magazine and whether customer will pay for it. Fahima did not have much information in this regard and had not really done a calculation. She also could not show measures that she would take to keep the business going in case the initial plan of selling print magazines will not work. The investor asked Fahima to come back later once the magazine operates for 3-6 months and then the investor would consider investing.

While the motivations for specific investors may be different, the most important consideration for you is to understand what the risks and rewards of your specific business are.

Once you are clear about what you have to offer, you not only have a better idea of who to approach for investment, but also an easy structure to talk to those potential investors about it.

Glossary Terms from this Section

Grantor - A person or institution that gifts out a sum of money with no contract of repayment.

Investors - An individual or company who gives money with the expectation of financial return.

Venture Capitalists - Investors who are investing other people's money.

Philanthropists - People who give large donations of money to good causes to help promote the welfare of others.

Risk - Taking a chance when you do not know how things will turn out.

For More Information Related to this Topic See

- How do I attract investors? *3. Access to Finance*
- Should I ask for investments from my friends and family? *3. Access to Finance*

12.

Should I ask for investments from my friends and family?

The Basics

Many owners think about asking friends and family for money to start a business because it feels easier, quicker, and more likely to happen than going to a bank or investor. Family and friends may seem like a great place to look for investment, but you want to make sure that you fully understand the possible conditions that may be placed on this decision.

Consider the following scenarios. Your Aunt Maliha agrees to invest in your business, but she wants to get free products or services in exchange for her investment. Would you feel comfortable asking her to sign a contract that specified how many products/services her investment entitled her to, and when she could receive them?

Aunt Maliha agrees to give you half of the amount you need to get started. She says that she will give you the rest of what you need later but it is not clear when that would be. Would you feel comfortable asking her to contribute the second half of her investment or asking for a specific period in time that it is needed most?

Your business starts to become successful and you have got an opportunity to talk with a huge potential customer. Your aunt wants to come with you to the meeting. Would you feel comfortable explaining why she should (or should not) join you?

In each of these scenarios, your personal relationship with the friend or family member has the potential to negatively influence your business decision.

Before accepting friends and family as investors, consider these two questions instead:

1. Do I want this person as an investor in my business? Do the benefits outweigh the disadvantages?
2. If my business does not survive, will their investment in my business create an unbearable tension in our family, and am I ready to take that risk?

And if you feel like you couldn't treat this person in a professional manner, or that your personal relationship would be irrevocably damaged if your business had to close, then it may be better to find your funding elsewhere.

Tell Me More

Many entrepreneurs rely on friends and family in their entrepreneurial journey. But having them as investors has the potential to create unnecessary conflict. If you are considering receiving funds from friends and family as potential investors, you should:

- Have a candid discussion about your mutual expectations before either of you agree to the investment.
- Know exactly what you need (money, introductions to other people they may know, business advice, etc.) and why you want it from them. Understand why they would be a good investor even if they were not your friend or family.
- If they are interested in helping you, also consider other ways for them to help besides a cash investment. Maybe they are great at accounting or have great design talents and could design a new logo for you.

- Make everything official. Always have legal documents and get everyone's signature on them. Document your discussions and notifications of your family investors in the same way you would with other professional partners.

- Ensure everyone has the same expectations such as their decision-making role (or lack of decision-making ability). Help them understand that they will not necessarily be running the business just because they invested in it.

- Treat them as professionally as you would an outside investor. Give them the same reporting, the same updates, and the same rights to be informed ahead of major decisions as you would want in their place.

- Understand what having friends and family as investors means for your future fundraising. Will they be able to continue to contribute as your company grows, or will you need to look for additional investors? If you will need additional investors, will having friends and family involved be an advantage or disadvantage to those future investors?

It may seem easier to receive money from your friends or family, but until you are clear that it is the right decision for your business, take some time to consider all the potential outcomes.

Glossary Terms from this Section

Investors - An individual or group who gives money with the expectation of financial return.

For More Information Related to this Topic See

- Why would someone else invest in my business? *3. Access to Finance*
- What are the kinds of investors and how do they work? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*
- What is a partnership and should I take one? *3. Access to Finance*

13.
What are the kinds of investors and how do they work?

The Basics

There are two types of equity investors:

- The ones who invest in you because they know and trust you (this includes friends, family, customers, employees, etc.).
- The ones who do not know you yet and are attracted to your business because of the opportunity it offers them.

Smaller companies are much more likely to receive investments from people that they know and are less likely to receive investments from "professional investors.". Professional investors are people or organizations that are looking for investment opportunities that will make a profit. These professional investors usually look for businesses that are bigger and more established.

It is important to remember that you are the first and most important investor in your business, because you are not only investing money, but also time and energy. Therefore, when you are thinking about your investors, do not ever leave yourself out.

When you are approaching investors who will invest because of their relationship with you, such as your family or friends, consider these questions:

- Are you clear about what you want these individuals to do for you? Be clear about your motivation for asking them to invest and your expectations. For example, if you want them to be an investor because they have an impressive reputation in the industry and could make useful introductions, say so.
- Do you need them to invest money, or could they help you more as (paid or unpaid) advisors or workers? Often, your family and friends will have a different idea of what is right for you and your business than you do. If they are advisors, you are free to listen to their advice and then make your own decisions. However, if they are also a co-owner of your business, you must give more weight to their advice and you could even see yourself outvoted if conflict arises.
- Will their investment strain or damage your personal (existing) relationship with them, and do you want to take that risk? Imagine that you invite a relative to invest in your company, and then you have to close down the business. What would your relative's reaction be? Could this create tension at family gatherings, or have other long-lasting impacts on your relationship? While no one can never fully predict what will happen, you do need to think about the possibility of failure when you are speaking with anyone who may invest in your company and be prepared if the worst occurs.

Last, when it comes to professional equity investors, you need to be sure that:

- Your company is at a point where it is large enough to be considered by them.
- You know exactly what a good deal looks like for you before you start talking to them.
- You are reasonably confident that you can provide them with the return they are looking for.
- You want to sell or merge your business in a relatively short time frame or share your profits with them over the long term.

In other words, do you really want a partner for the life of your business, and under what conditions?

Tell Me More

Professional equity investors come in two basic types: angel investors or venture capitalists. The distinction between these two groups is based on whose money they are investing.
Angel investors are investing their own money, while venture capitalists are investing other people's money. These different approaches will influence which companies they choose to invest in, as well as their ability to assist you after they've invested.

Since angel investors are pursuing their own interests, it may be easier to approach them and to identify whether they can provide you with things other than money (introductions, business strategy, etc.). However, they may also have another job, other investments, and additional obligations that can make it more difficult to communicate with them on a regular basis.

Venture capitalists, on the other hand, usually have a more professional approach and can clearly outline the amount of time they will be able to provide to you for introductions, business strategy, etc. The downside is that most of these types of investors are well known and have many people also asking them for investments.

Other key differences include:

- The amount of funding they provide – angels generally provide lower amounts to smaller companies.
- The types of investments they consider – angel investors often look at all types of businesses, while venture capitalists usually specialize in certain industries or technologies.

The similarities between angels and venture capitalists include:

- A demanding process to judge if the company is worth investing in (usually involving attorneys, accountants and industry specialists)
- They will be hard negotiators of the investment terms
- They will base their investment on a specific financial value they place on your company

One Afghan company, namely 786 Pharmacy, is known for its success in attracting investment from venture capital firms. The company provides high quality standard medicine through a chain model of stores named "786". The company attracted investment from a venture capital firm and went from a few stores to about 22 across Kabul. The company also benefited from the business and management requirements of the venture capital firm to ensure 786 has sound financial system, management, and quality control measures in place. You should remember that venture capital investors are not very common in Afghanistan yet. Informal investors, such as family and friends, or angel investors are more common.

What does it mean to have an investor consider the value of your company in the negotiations?
This simply means that the investor looks at three elements to determine the terms of their investment:

1. What your business is worth today?
2. How much investment you need to accomplish your goals?
3. What your business will be worth after you accomplish those goals?

Instead of simply giving you money and knowing they'll get it back plus interest (like a lender), an equity investor needs to know how much of your company they will own for a given amount of investment. The negotiations generally happen in percentage terms (500,000 AFN for 20% ownership, for example).

Since your equity investor will be a co-owner of your business, one of the biggest questions that you need to answer is "how much of my company am I willing to give away?" Since your investor will be a co-owner of your company, once they own more of your company than you do, they are the ones with more influence in making the decisions. Many SME owners always try to keep at least 51% of the company's ownership to ensure the decision-making power is not taken away by the investors.

That is where understanding the value of your business today and in the future, becomes useful.

Would you be better off if you owned 100% of a company that was worth 500,000 AFN or 10% of a company worth 10,000,000? In strict financial terms, the second option gives you more money (10% of 10,000,000 = 1,000,000, or two times the value of your 100% ownership in the small company).

There is no one way of determining what your business is worth. Some business owners may count up the value of all their assets, like inventory, property, and equipment, to get an idea of what a business is worth. Other business owners will instead look at how much sales they are making and use that as a basis for a valuable. For instance, a business owner that has 500,000 AFN a year in sales may think that the value of her business is two or three times her sales. There are other financial methods for coming up with a value for your business, and there are some non-financial methods too. For instance, maybe you own a grocery store that is located next to another person's café. If that person were considering buying your grocery store, they may value your business higher simply because of where it is located. While deciding on the value of the company comes down to how much you think it is worth (and if you can defend that number to other people), it is a good idea to seek out the help of others when determining the value. Mentors, other entrepreneurs in your network, and financial experts may all be able to help you decide how to place the right value on your business.

Glossary Terms from this Section

Angel Investors - Investors who are going to invest their own money.

Equity Investors - People who invest money into a company in exchange for part ownership.

Venture Capitalists - Investors who are investing other people's money.

For More Information Related to this Topic See

- Why would someone else invest in my business? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

14.
How do I find investors?

The Basics

When your business gets large enough and you start to consider finding investors, you must know:

- How much investment you need and how it will help you achieve your business goals?
- What your long-term plan is for your business (sell it, give it to kids, keep it for steady income)?
- What kind of investment fits your business best (grant, debt investment, equity investors)?
- What your business is worth now and in the future?
- What a good deal looks like for you?

Knowing how much investment you need and what your long-term goal is, you can decide what kind of investment fits you best. There is no reason to look for equity investors if you do not want to sell the business.

After you have decided what kind of investment fits you best, it is important to determine what a good deal looks like for you. If you are looking at debt, you will want to think about what interest rate or fees are acceptable for your needs.

If you are looking at equity, you need to understand what your business is worth now and in the future, and determine how much of your company you are willing to offer an investor. Another big question is that of decision-making. Are you willing to allow your investors to control the majority of your company? This means that they would be able to make decisions for the business that you may not agree with.

Tell Me More

Once you know how much money you need and how it will help you achieve your business goals, as well as which type of investment you are looking for, you should:

- Prepare a business plan or funding request document that will help an investor understand the opportunity you are presenting them. It is crucial that all of the information contained in this plan is backed up by the data you have available (unit economics, customer/vendor/employee contracts, a working prototype, market research data, financial projections, etc.). If you can't prove something that you are saying in the business plan or funding request, do not ask for funding until you can.

- Develop a one-page executive summary of that business plan that you can provide as a starting point to interested parties. Do not include anything confidential in this document.

- Make a list of the best "investors" for you – this could be banks, grants, angel investors or venture capitalists.

- While you are researching potential investors, prepare your presentation based on your business plan or funding request document. The presentation describes the opportunity you are offering to an investor in a way that is exciting and easy to understand. The goal is to tell a story that connects with them, but also gives them enough information to see that you are credible.

- **Research each potential investor and divide your list into three categories:**

1. Ideal investors – these are your "dream" investors, because they are a low probability.

2. Investors that would be great for you and that you believe you have a good chance of getting a "yes" from
3. Investors that you know would say "yes", but may not be your first choice.

- Starting with the last group (your less-than-ideal investors), search your contacts and other sources (online, social media, etc.) to find a way to connect with the investor directly. Also, a "warm" introduction can be made by someone (i.e. a friend or acquaintance of yours) that the investor respects or has had good experience with in the past.

- As you are looking for ways to connect with the contacts, develop a simple email that you can send to investors that summarizes your company and your investment request in 2-3 sentences. This message needs to be brief but exciting, so that they want to learn more. In the message, be clear about what you want the investor to do; do you want to have a 15-minute call with them? Meet them for tea? Make it easy for them to say "yes" or "no" quickly.

- Send your short email to the last list of investors first (those that are not ideal) and get their feedback. Even if you may not want them to invest in your company, it is worth meeting with them to understand the strengths and weaknesses they see in your pitch deck, executive summary and business plan / funding request.

- As you build confidence and refine your investment materials, move up your list of investors to those who are more attractive to you.

Be prepared to speak with many people during the process of getting investment. It can take months or even a year or longer to obtain a grant, loan or investment.

It is crucial to remember that getting an investor attracted to you is only the beginning of the process. Once you enter into discussions with investors, there are still several steps to complete before you receive your money:

- Letter of intent or memorandum of understanding (MoU) – this is a formal "offer" to invest, but does not guarantee that the investment will happen.
- Underwriting or due diligence – this is the process that investors use to understand if everything you told them is accurate. It will involve lawyers, accountants and industry experts.
- Contract negotiation - this process can happen at the same time as due diligence, but it focuses on the legal documents needed for investment
- Closing - this is the "official" signing of all the investment documents by both you and the investor. It can take some time, since this is the moment when last minute issues must be resolved.
- Funding - this is the moment when the funds are actually moved into your bank account and ready to be used.

Glossary Terms from this Section

Angel Investors - Investors who are going to invest their own money.

Business Plan - A written document that describes how a business plans to reach their goals.

Debt Investment - Money loaned to a person or organization with expected return with interest.

Equity Investors - People who invest money into a company in exchange for part ownership.

Investors - An individual or company who gives money with the expectation of financial return.

Venture Capitalists - Investors who are investing other people's money.

Equity - The company assets that the owner owns.

Debt - Money borrowed from one party by another, often a loan from a bank.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What is equity funding and how does it work? *3. Access to Finance*

Additional Tools Available

Common Funding Sources in AFG

Sample Contract

Sample Memorandum of Understanding MOU

15.
How do I negotiate the terms of getting capital?

The Basics

Negotiations are always personal and no generalization can replace your awareness of the situation and your relationship with the person on the other side.

The best rule for negotiating during fundraising is to know what a good deal looks like for you, and even before you begin negotiating, decide at what point will you say "no" to the deal. For example, Khatera Rahman was looking for an investment of 900,000 AFN to expand her pharmacy to have more storage space for medicine. She wanted investment, but not at the cost of losing control of her business. Khatera decided that she would seek out a single investor that would pay 900,000 AFN in return for a 10% share of her company. However, she preferred to have an investor that also brought experience in the health sector, in which case she would be willing to give up to 15% of her company's share for the 900,000 AFN.

Identify what you will and won't accept, and while you may indicate the former in your presentation materials, keep the latter to yourself. It is crucial that you write it down, because in every negotiation there comes a moment when you just want to say "yes" to be finished with the negotiation even if you didn't get a very good deal. Having written criteria that you agree must be met can be very helpful for you when the negotiation becomes stressful.

Once you have your own rules, you can also research what is appropriate and customary for each potential investor and the investment you are offering. What you think is not as important as what has been done in the past, because people feel comfortable repeating their own patterns.

You can find others who have worked with the investors you are considering, seeing what was negotiable, what worked and what didn't. In the case of Khatera, she did not have difficulty researching about two of her potential investors as both were referred by another female entrepreneur. Khatera asked her friend for more information about the investors' previous deals and ways to negotiate a good deal for her company. You can also find data about past transactions to assist you in evaluating what a transaction with different investors might look like.

Ultimately, though, do not be afraid to say "no" and walk away from the deal if the terms are not suitable to you, this is one of your biggest negotiating tools.

Tell Me More

Negotiating an investment in your company can be a challenging and frustrating experience. Here are some best practices to assist you:

- Know your worth so that you are as attractive as possible to the investors you are pursuing.

- "I need money" is not an investment request. Know enough about your business so that you are confident asking for the deal you want. Have specific information about where the money will be invested and when the investment will have a return. Be prepared.

- Identify the things that you are absolutely not willing to change your position on before you get involved in a negotiation. Consider creating your own best-case scenario terms even if you do not show it to anyone. Thinking through these items before the discussions will give you a much better chance of getting the best possible deal.

- When someone tells or shows you who they are, believe them. If you don't trust someone, or you don't think that they are a fit for your business values and goals, do not pursue that money. It can be tempting to take money thinking you can change a person or learn to live with a bad situation. In the long run, taking this kind of money will make problems for you.

- Funding is a market just like every other market. There are times when there is a lot of money available for deal and there are times when not many deals are getting made. This means that while past transactions can be an indication of what kind of deal is possible, but you won't necessarily get the exact same deal as someone else.

- Be sure that any negotiations with family and friends are particularly clearly documented, and that everyone feels comfortable with what is being done. Ask yourself if you would feel good about the level of information you are providing if it were your relative asking you to invest.

- Negotiate in good faith and tell the truth. This does not mean you must bring up things that are not being asked, but do not lie. It will always come back to hurt you.

- Clearly understand your and your potential investor's other options are. If you understand what yours and theirs other options are, you can better predict how they will react to your offers and decide when it is time to move on if the negotiations are not progressing.

- You may be an expert in your business, but you are not your only resource. Use lawyers and any other professionals who may be able to provide you with the information you need to make the best decision for your business.

- At the same time, do not rely on anyone else to know what is right for your business. If your lawyer tells you that this is a "really good deal" you still need to review it for yourself and understand what you are agreeing to before signing.

Although each investor is different, there are some general rules that you can apply:

If you are looking for a loan, lenders can usually negotiate interest rates and some fees. Pay attention to fees related to late payments, pre-payments (when you reimburse your loan earlier than expected), or lien releases (when the lender transfers title of your asset back to you), as these can add up. The loan agreements themselves usually cannot be changed, and if you are pledging collateral or offering a personal guarantee, you may have to sign several different documents to accomplish this.

If you are looking for equity investors, there is no generally accepted "standard" document, although each investor will have their own "standard". This means you need an attorney to help you review each document carefully to understand your rights and obligations.

Most everything is negotiable. This is why you must understand what you will and won't agree to, so you can quickly identify any unacceptable provisions right away.

Glossary Terms from this Section

Collateral - Something of value you own that will be taken if the loan is not paid back.

Fundraising - Seeking to generate financial support.

Investors - An individual or group who gives money with the expectation of financial return.

Lender - A person or organization who offers others an amount of money to use for a fee.

Lien Releases - When the lender transfers title of your asset back to you.

Personal Guarantees - An individual's legal promise to be responsible and repay any debt that the business cannot repay.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What is equity funding and how does it work? *3. Access to Finance*
- What does the bank look at when deciding to make a loan? *3. Access to Finance*
- What is collateral? *3. Access to Finance*

Additional Tools Available

Approaching an Investor Checklist

16.
How do I maintain a good relationship with lenders or investors?

The Basics

Keeping your lenders or investors satisfied with their investment in your company is important, particularly if you believe you will need additional funding in the future. To keep them happy, follow this simple rule: Do what you say and say what you do.

What does that look like in the real world?

- Provide regular updates in a way that keeps them excited about your business and helps them understand where they could help you more.
- Be respectful of their time and expertise. Do not ask them for something and then ignore their response because it wasn't what you wanted to hear.
- Understand your obligations and respect them. Pay on time, deliver information when requested, and respond to their inquiries professionally and promptly.
- Communicate as early as possible if you think you won't be able to keep your obligations. Do not wait and hope that things will just work out on their won.
- Keep good documentation of your transactions and particularly avoid flaws in your financial reporting. Being honest about your financials (i.e. revenue, expenses, profit, etc.) builds trust.

Does this mean you have to do everything they ask? No, but it does mean you need to be professional and responsive. It also means that you need to be very clear about what your obligations before you accept their money. That is why the contents of the agreements your sign are very important as they sets the stage for the rest of your relationship with the lender or investor.

In a printing company, owned by Hamida Wahidi, the investor with 25% share in the company had to sell his share back to the company after two years of operation for one main reason. Hamida was the CEO and worked day and night to make sure the company met its goals. The investor, however, would intervene in small decisions of the company that were the responsibility of Hamida. One time, he asked Hamida to hire two of his relatives in the company. Hamida denied the request and told the investor why the two candidates were not qualified and not needed in the firm. While Hamida was very respectful and professional because the investment agreement had clear guidelines for decision-making, the investor continued to ignore strategic decisions and focus on day-to-day operations. After long discussions, Hamida convinced the investor to sell his shares back to the company and end the investment agreement. It is very important to clarify roles and responsibilities of your investor upfront to avoid future confusions.

Most professional investors have quarterly reporting requirements, and some require audited financials and other detailed reports. Individual investors (such as a friend who has invested in your company) may not be as strict in requiring periodic detailed financial reports, but it does not mean you should maintain and share financial reports. Be sure that you can fulfill these requirements before making an agreement. Many investors respond that they feel shut out as soon as the money is given. If your goal is to ensure that your investor continues to believe in you after they have invested, be sure to maintain communication and involvement as appropriate.

If you see that you won't be able to deliver what you have promised, discuss this as early as possible. Be proactive. Do not wait until the due date to send an email, or wait until they contact you for an update. The more professional and proactive you can be, the more confident they are in your ability to manage your business.

Tell Me More

While it can be intimidating to talk to investors, once you sign an agreement with them regarding their investment in your company, you have an obligation to them. Generally, investors want to understand how you are using the money given to you, and what results you are getting with their investment.

This is true whether the investor is someone you know or someone you only have a professional relationship with.

An investor may request:

- Frequent (every 1-3 months) meetings to get an update on your progress in terms of investing the money and generating revenue
- Written updates and financial statements (usually quarterly, but could be more frequent)
- An annual presentation of your company and its progress – either in-person or written (or both)
- Conference calls or other discussions for answers to their questions
- The right to participate in strategic discussions and decision-making, usually as a member of your company's senior team

This may feel like a lot of obligations, but investors can also provide you with resources you couldn't obtain on your own, including:

- Money
- Access to other investors
- Introductions to potential partners or customers or employees
- Industry expertise that can benefit your business
- General business experience that can help you navigate building your business more efficiently

One of the most difficult times to communicate is when things are not going well. It is always difficult to explain that things didn't work out the way you'd planned, and you may be afraid that your investors will blame you for the company's difficulties.

While it may feel easier to ignore your obligations, it is the worst thing you could do in a situation. In fact, if you approach investors early on, they may have some helpful suggestions that could improve your situation. Of course, you need to approach investors with an assessment of the facts and a plan of action, not simply "it didn't work and I do not know what to do now."

In these situations, it is also crucial to remember that you can't simply ignore your investors. Whether you have borrowed money from them or they are an equity investor in your company, you have a legal obligation to protect their interests as well as your own. Walking away from the company is not an option once you have taken on investors. Not only would this severely damage your reputation as a business person, but this could create legal liability for you as well.

Glossary Terms from this Section

Investors - An individual or group who gives money with the expectation of financial return.

For More Information Related to this Topic See

- What are the kinds of investors and how do they work? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*

17.

How do I manage my own personal investment in my business?

The Basics

It is very common for business owners to invest their own personal money to help get the business started and/or fund a needed piece of equipment or expansion goal. There are financial investments but there is also personal time and energy invested. Managing your personal investment means identifying what return of value you will get back on your investments.

Know what you are investing.

Many owners ignore the fact that they are not only investing money in their business, but also their time and energy. When you are looking at what you have put into the business, it is a great idea to keep track of your time as well as any financial investment. Think about the value of your time as if you worked for another company and received a fixed salary. The amount of salary you forgo to work on your company should be added to the actual cash you invest in your business. When you respect and value your time, future investors will feel to do the same.

Understand the return (you think) you will get in the future.

When you started your business, you probably had a big goal. Maybe you wanted to make enough money to support your family, gain some additional income, help provide schooling to your children, or provide a service to the community. Future return on your investment in a successful business can come in the form of personal satisfaction and purpose and/or financial return to you in the form of a salary, distribution of profit to shareholders, or a lump sum if the business is sold.

Tell Me More

Financial return on your investment can come from your business in two ways:

- income (such as salaries and profit distributions) and
- long-term value (such as the sale of your business)

You want to be sure that you are making the most of your returns in both areas. If you decide to give up income (like a salary) to reinvest in your business, you need to be sure that you are pursuing something that will have significant long-term value to your business. You should not make it a habit to not pay yourself a salary.

There may be times when you can sacrifice your salary for a short time, but it is important to develop your business so that it is healthy enough to provide you with a regular salary.

How do you determine return on investment?
The calculation of a return on investment (also called ROI) is simply the amount of return divided by the initial investment. For example, if you sell your business for 1,500,000 AFN after having invested 50,000 AFN, the return on your investment would be ROI = 1,500,000 AFN / 50,000 AFN = 30, or a return of 30 times your initial investment.

Depending on how long it took from starting to selling the business, this could feel like a really great return. But there are a few elements missing from this calculation. For example, did you work in this business every day? In this case, your investment could be significantly higher than the 50,000 AFN indicated.

Assuming that your time is worth 100 AFN per hour, if you worked in the business full time (2,000 hours per year) for 5 years, your total investment would be 1000,000 AFN. You invested 50,000 AFN in cash, but also 1,000,000 (100 / hour x 10,000 hours) of work into the business.

You may also have earned a salary during the time you worked, in which case you received more than 1,500,000 AFN in return. Assuming you paid yourself an annual salary of 20,000 AFN, the 1,000,000 AFN of work you provided was also returned to you and should be included in your calculation.

Now the ROI = (1,500,000 + 1000,000) / (50,000+1,000,000) = 2,500,000 / 1,050,000 = 2.38 times your investment.

This simple calculation shows you one of the misperceptions of business ownership – that owners should ignore their own time when thinking about return on investment. By also calculating the value you yourself have invested into your business, you can get a better picture of the amount that is returned to you after selling the business.

Thinking about your return on investment daily can be very helpful. Ask yourself what return you are getting on the different activities that you are doing. If you choose to make customer deliveries each day for a few hours, for example, think about the value that adds to your business. Could someone else make those deliveries at a lower cost per hour? And what could you do that would add more value to your business if you had that time back?

As you are making decisions every day in your business, focus on how what you are about to do can add value to your business in more than just making money. If you are not sure how it is adding value, it may be a good idea to limit the activity until you do understand the value that activity brings or does not bring to your business.

Glossary Terms from this Section

Return on Investment (ROI) - A formula used to compare how profitable and efficient your business or certain projects are.

For More Information Related to this Topic See

- How do I know if I need capital and how much will I need? *3. Access to Finance*
- Why would someone else invest in my business? *3. Access to Finance*
- How much does it cost in effort and funds to get and manage a loan or investors? *3. Access to Finance*
- Should I ask for investments from my friends and family? *3. Access to Finance*

18.
How much does it cost in effort and funds to find capital?

The Basics

Finding capital and maintaining relationships with lenders and investors is always a time-consuming process. It is important to keep your primary goal in mind all the time. Your primary goal is to build a viable business – not to just finding capital.

Time and energy are your most valuable resources. Finding funding can take anywhere from 2 months to a year to even longer. If you pay to travel to visit banks/investors, to have your presentation professionally designed or printed, to attend conferences, or spend time on grant applications, the financial cost of finding capital can add up quickly and be a significant amount.

It is crucial to manage your time, energy and money throughout the process, and to only do things that you know will move your business forward. This means focusing on things that will build your business, instead of thinking that getting funding will make your company something that it is not.

Many people start their search by rushing to talk to lenders and investors or get meetings. This approach will not have any lasting value for your business unless you have already done the necessary work to give yourself a decent chance of success. Invest your time and energy into talking to your customers, implementing your business model and pursuing a clear path to making a profit. Do everything you can to develop a strong foundation for your business that is worth someone investing in.

By becoming a good investor of your own time, energy and money, you will be much better prepared to talk to investors if and when the time is right.

Tell Me More

During the fundraising process, there are plenty of ways that you can waste time, energy and money. Some of the most common are:

- Not knowing how much funding you are asking for. Too often, owners confuse their immediate cash need (I need 35,000 AFN to pay this month's salaries) with an investment request. Use your future financial estimates to see how much cash you will need in the next 12-18 months, and what you could use that cash to achieve. Until you are able to understand and plan how the investment can be used for more than the short-term, you are not ready to consider your funding options.

- Not understanding what type of investment is right for you. You can get funding from many different sources – gifts, grants, loans, investments. These different kinds of funding all have different requirements, costs, and are paid back in different ways. It is up to you to identify which type is correct for you and pursue it.

- Pushing to get meetings before you know that they are the right lender or investor for you. Talking to "just any anyone" will get you "just any" results, which means you are wasting your time as well as the investors'. Being selective about who you talk to and when not only saves you time and energy, but it shows lenders and investors that you are proceeding in a logical way and using your time wisely.

- Investing time and energy into a pitch to investors without understanding why you need the money, how it will help you achieve your business goals, or even if your business is big enough to justify an investment. It is crucial to understand how the investment you are requesting will move the business forward in a meaningful and measurable way before building a request or talking to investors. The more specific you are with your goals, the easier it is for investors to understand you. For example, if you wish to increase your production from 500 to 5,000 cartons of potato chips each week, you should find mention that to the investor, along with an estimation how much revenue and potential profit it will bring.

Finding the right source of capital shouldn't be left to chance - it requires a process, just like getting customers. The good news is that you already know these steps, so reduce your stress by treating your capital search just like you would a customer search:

1. Identify the right lenders or investors for you.
2. Find a way to attract them.
3. Convince them to work with you.
4. Negotiate and sign the agreement.

Glossary Terms from this Section

Fundraising - Seeking to generate financial support.

Investors - An individual or group who gives money with the expectation of financial return.

Profit - Any positive amount of money left over after subtracting expenses from revenue (income).

Business Model – A company's plan for how it will generate revenues and make a profit.

For More Information Related to this Topic See

- How do I know if I need capital and how much will I need? *3. Access to Finance*
- How do I attract investors? *3. Access to Finance*
- What is equity funding and how does it work? *3. Access to Finance*
- What is debt funding and how does it work? *3. Access to Finance*
- What are the different types of loans and how do I get them? *3. Access to Finance*

Additional Tools Available

Start Up Costs and Growth Capital Worksheet

19.
What is a partnership and should I take one?

The Basics

Partnership usually describes two or more people who agree to work together in a business and share the profits in a pre-determined way. The partners can also be called "co-founders" if they all started the business together. The partners of a business do not usually earn a salary and depending on the way the business is set up, they can each be responsible for the debts of the business.

There are a few things to think about before agreeing to a partnership:

- Do I clearly understand what the other person will bring to this business? In a business, it is helpful to have a variety of skills, so taking on a partner whose strengths complement yours is much better than taking on a partner who has the same skills you do.

- Am I okay sharing the profits of the business with this person? Partnerships run into trouble when the roles and expectations of each partner are not clearly defined. Imagine that you run a retail store, and your partner never comes in to work, leaving you to do the bulk of the work to keep the business going. Would you still feel that sharing the profits equally was fair?

- Do we share a common goal for this business? Since a partner is a part owner of the business, you will need his or her agreement to sell or make major changes to the business. Having a common vision of what you'd like the business to become can avoid major disagreements later.

A very common mistake that businesses make is to partner with friends without discussing and agreeing terms of the partnership. During establishment phase it might sound right to work together without much accountability as the business may not have much revenue, but once revenue comes in, partnerships face conflicts and at times fall apart. If you are still confident that a partnership is good for your business, it is crucial to document everything with your partner in the same way you would with a lender or an investor.

Treat your partner in the same way you would a relative or friend who invested in your business. Make your expectations clear, as well as any and all compensation that you and your partner will receive. Lastly, have a regular partners' meeting set up, so that you can both (all) discuss your ideas, suggestions and concerns. Business partnerships are long-term relationships, so it is important to keep communication open and honest, and to allow each partner to serve the business in a way that benefits everyone.

Tell Me More

Having a partner can be very helpful, especially when a business is just starting out. Not everyone you know is a good partner for you and your business. This is why it is crucial to understand what your expectations of a partner are before you go looking for the right person.

When considering a partnership, it can be useful to note your strengths and weaknesses, and then see how those overlap with your business plan. If, for example, you need to pre-sell your product or service in order to get your business started, you will definitely need someone who is good at talking to customers. If that is not one of your strengths, taking on a partner who can do that will be essential to your success. If you are great at talking to customers, but need someone with operational skills, those are the qualities you want to look for in a partner.

As you will be working with your partner throughout the life of your business, you want to ensure that you share a common vision for the business and are able to communicate effectively. This means not only getting along with each other on a daily basis, but also being able to address problems in a respectful and professional manner.

There are certain to be some challenges or difficulties over the life of your business so it is also important to think about and document how you will resolve those conflicts going forward. As a part owner of your business, any partner you bring on will not only have responsibilities but also rights to participate in major decisions.

Owners normally have voting rights equal to their ownership – meaning that if you and your partner each own 50% of the company, you won't be able to simply vote to make decisions. Since you both own half of the company, you will need to decide how conflicts between you and your partner can be resolved. Will certain decisions be delegated to one partner because of their area of expertise? Will there be an outside expert who is consulted in case of disagreement?

It is best to decide and document these arrangements as early in the partnership as possible. A good lawyer can also suggest methods that he/she has seen succeed in resolving conflicts, including the possible termination of the partnership.

Lastly, you need to consider how the partnership will end:

- What if one of the partners isn't doing the work they are expected to do?
- What if one of the partners becomes incapacitated or dies?
- If your company is sold, how will the sales proceeds be shared?
- If your company needs to close because it is not profitable, who will be responsible for staying with the company during the closing period? Who will inform the employees and manage the vendors?

The more of these details you can identify and agree on early in the partnership, the lower your stress will be as your business grows.

Glossary Terms from this Section

Business Plan - A written document that describes how a business plans to reach their goals.

Investors - An individual or group who gives money with the expectation of financial return.

Lender - A person or organization who offers others an amount of money to use for a fee.

For More Information Related to this Topic See

- Why would someone else invest in my business? *3. Access to Finance*
- Should I ask for investments from my friends and family? *3. Access to Finance*
- How do I manage my own personal investment in my business? *3. Access to Finance*

Additional Tools Available

Financing Options Summary

Tools