Microloans Could Fuel Macro Results (*Entrepreneur Magazine* – April 15, 2002)

The term microloan comes from the very small size of the typical funds borrowed. These range from $100 to $35,000 and can be used for the purchase of furniture, fixtures, machinery, equipment, inventory and working capital. Commercial banks deem these amounts too small to bother with. The Small Business Administration also has the Microloan Program, which is designed to help applicants who cannot qualify for a traditional business loan because of poor credit (or lack of established credit) and little or no collateral. It is fairly normal that during their first 18 to 24 months of operations, small startup businesses have not been functioning long enough to develop reliable cash flow or the necessary financial viability to qualify for commercial credit.

Loans can be made to any type of business, but it must be a corporation or a limited liability company (LLC), as microloans cannot be made to individuals. These programs are designed to pick up where the commercial banks leave off. When smaller, newer companies cannot get funded by traditional bank programs, the microloan process should be the next step. For example, the Micro-Loan Program can provide between $10,000 and $15,000 in short-term funds based on your firm's monthly average credit card sales on Visa and MasterCard only. The funding group would then loan 70 to 100 percent of the average monthly credit card transactions. The microloan principal and interest are paid back as customers continue to use their Visa and MasterCard as a steady percentage component of your firm's sales. Typical terms for a six-month period would have a minimum monthly payment amount of 12 to 15 percent of the firm's average sales.

The Microloan Program is offered in every state; however, the cost of the loans will be higher than with a basic bank loan. Some microloans have even morphed into convertible-equity deals, providing up to $100,000 in startup capital. The borrower pays interest only (no principal) during the first two years and can exercise an option to convert the loan to a common stock position in the firm. Then the borrower repurchases the stock using profits eventually generated by the business, or other funds coming from a second round of financing from a different outside source. In the long run, this can be more risky for the entrepreneur, due to the higher costs on microloans with these provisions. But if the choice is between a low-cost loan that your firm cannot qualify for, or a slightly higher-cost microloan that you can qualify for, then this program could put some initial funding in your hands fairly quickly. For example, a $10,000 microloan borrowed for one month could cost around $400 (4 percent for 30 days). That same $10,000 on a fully amortized program would cost just over $1,400 for six months (average of only around 2.3 percent for 30 days).

When evaluating any microloan program, be sure to have a firm understanding of how much capital you need, and how much your business can afford to pay back on a monthly or quarterly basis. Have a clear picture of the "uses of funds," a line-item summary of how the money will be spent, and specific targeted returns in sales revenues generated from each area where funds will be allocated. The objective is to gain some traction in your initial market space, kick-start some buying activity from your primary customers, and get cash flow up to a baseline point where interest on the loan can be paid back without interruption for the next six months to a year. Then, when the principal is also repaid, that high-priced, risky microloan may turn out to be your firm's clear demonstration of well-managed debt, and can improve (or establish) your credit rating as well as open up future doors to more traditional bank financing.