

What Lenders Want: Financing Your Aquaculture Enterprise

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Introduction

Aquaculture is a “new” industry. Though fish have been farmed for thousands of years around the world, lenders view loan applications as higher risk enterprises because of their novelty. Because of this it is even more necessary than in other business plans, to present a clear, well projected image of the business.

The business plan, accompanied by the loan application package, is the one instrument the entrepreneur has available to “sell” his business to the lending institution. The plan should provide a crystal clear impression of the technical, marketing and financial aspects of the business. The lender, who may not know aquaculture operations, should be able to understand as much of the proposed business plan as possible.

What Lenders Want

Lenders surveyed for this paper stated that first and foremost they wanted a realistic document about the business. Reasonable financial statements, clear marketing and technical information and relevant analysis of potential problems the business could face ranked highly on their list.

Lenders also use certain flexible criteria to evaluate loans, including cash flow statements, financial ratios, ability to provide collateral, experience level of management and product market status.

The Business Plan

Lenders prefer to see a fully developed business plan for the operation. (See Appendix for an outline of a model business plan.) Survey respondents indicated that a plan that read well, was convincing and well documented would receive further evaluation on a more positive note than a “scantily” prepared submission.

Financial Statements

Lenders prefer minimum of four years of financial statements including most importantly the cash flow statement and income statement. Data should be projected monthly for the first two years, then quarterly thereafter. Most lenders indicated that they preferred

sensitivity analysis be conducted on the financials to show the impact of changes to the firm. (Changes could be anything from fish and feed prices to increased mortality.)

Financial Analysis and Ratios

At the top of the lenders list was the need for a cash flow statement. The primary question to be addressed, which if negative, will end the loan process, is “Can the company meet its financial obligations?” A positive cash flow throughout the projection period is essential. Lenders do, however understand the timing of harvests and expect the borrower to adequately fund the business either through debt or equity, in order to prevent negative cash flow periods.

The second most important financial aspect was the debt/equity ratio. This ratio is total liabilities divided by total equity. Needless to say, the higher this ratio, the riskier the business. The lender wants personal investment in the business. Survey respondents indicated that lenders required, depending on many other factors, from 10-30 percent personal investment in a business.

Most lenders stated that collateral was a tricky issue. Average stated required collateral was 60%. This is a qualified statement, that the stronger the proposal, the more flexible collateral requirements are.

Marketing

Lenders are taking a new and intensified look at the marketing plans of potential companies. They require price and quantity history. They want reassurance that the firm has a viable market that will perform to the expectations of your financial projections. If possible, show market growth trends; provide intent to purchase agreements and document any supply deficits possible.

Other Issues

Lenders are also interested in aspects other than financial ones. A very important issue is the experience level of the management team. Most survey respondents indicated that without adequate experience or training in the field, they were unlikely to fund a new venture. If management is not experienced in the field of aquaculture, it helps the application to hire someone on the management team who is.

Another critical issue for lenders is the willingness of entrepreneurs to sign personal guarantees for the debt. One respondent indicated that to his bank, this indicated a personal belief and trust in the business. Most banks indicated that they require personal guarantees on the majority of their loans of this type.

One surprising item that bankers considered was personal ability to survive a failure. As personal guarantees are nearly always required, the banks consider whether the individual

owners could survive the failure of the business. One lender stated, “If the business fails, there is one bankruptcy. There shouldn’t have to be two.”

Summary

Lenders want to finance successful businesses. The guidelines lenders use to evaluate loan applications are to protect not only themselves, but the clients as well. Evaluate the business plan on the criteria that lenders use before you submit it. This will increase probability of financing and a successful venture.

Appendix: Parts of a Business Plan

Executive Summary

The most important part of a business plan, particularly for those trying to finance a new business or expansion of an existing business is the Executive Summary. This is the first exposure to the business concept and plan that most lenders will have. Therefore, it must be concise, compelling and informative. It must entice and convince the reader that the rest of the plan, and therefore the business, has merit. The Executive Summary should address these issues:

1. How the company is organized (corporation, partnership, etc.), its stage of development (currently in operation or on paper) and the company's mission.
2. (Was it a fit with available resources or training? Was an unmet market opportunity recognized? What are the products to be offered?)
3. What is the target market?
4. Why can this company meet market needs and face the relative competition? (In other words, what is your competitive advantage or edge?)
5. Why is management capable of running this particular business? (Indicate training, background, previous employment, etc.)
6. Briefly list milestones for the business. For example, 1 million pounds per year by year 2, when the first products will be shipped, what percentage of what markets do you think you can obtain and by when.
7. Specify your financing plan. How much equity from owners do you expect? How much credit from lenders will you require? How will lenders be repaid and how will investors be compensated.

Company Description

1. Legal name and form of business

The company should have a legal status for the state in which it operates. This could be a privately held corporation, a publicly traded corporation, a partnership, a limited partnership, an individual proprietorship and many permutations in between. It should have a legal name for this status. This is the name the business will be known to the state in which it operates and to the Internal Revenue Service. Include the date of legal formation.

2. Company's mission and objectives

This should describe what the company's overall goal is and its objectives toward meeting that goal. A mission could be very general or specific, depending on the nature of the business.

3. Top Level Management

This will name and describe the qualifications of the business's management team. Stress any particular training, education or experience that will be beneficial to the business. Try to show that all areas of the business (including management, marketing, finance and operations) are well covered managerially.

4. Location and geographical information

This gives the physical address for the information and any details as to why this location is favorable for this endeavor.

5. Company development stage

This should describe where the company is as of the time of the plan. Is it just a well researched business on paper? Is this an expansion or combination of existing business(es)? How much prior experience in this field is the company bringing to the fore?

6. Company products and/or services

What does the company offer for sale? Is it live or processed? What does it offer besides the physical product? (Do you offer assistance to the buyers in dealing with the products? Are consulting services offered?)

Industry Analysis

1. Size and growth trends

What is the current size (dollars and quantity) of the industry? Give overall statistics for the whole industry and specifics for the part (by species and product form) of the segment. How fast are both the industry and the target segment growing?

2. Maturity of industry

Is this a mature industry? For most aquaculturists, with the exception of southern catfish farming and potentially natural spring trout farming, the industry is still in its beginning phases.

3. Potential impact of economic factors

What impact does the overall performance of the economy have on the business? For example, if interest rates are high (and therefore disposable income down), and the product is considered a "luxury" as many seafood product are, high interest rates could have a depressing effect on sales.

4. Seasonality

Does seasonality play a role in the business

5. Technological factors

Is the technology proven? Is it operational in other facilities? Is it operational in research facilities? What documentation/data can be provided to support these facts? Are there patents or proprietary processes that give a competitive edge?

6. Regulatory issues and permits

What are the significant regulatory guidelines with which the business must comply? How will they be complied with? What permits need to be obtained to operate? When

will they be obtained? Do any of the regulatory issues or permits effect this business differently than the competition and why?

7. Supply and distribution

What is the supply situation for the industry and how is it distributed?

8. Financial considerations

What does it take investment-wise to become a recognized competitor in this industry? How heavy is competition and how does that relate to the need to have heavy cash reserves ("deep pockets")? Are there impending regulatory changes that will require further investment? Consider regulatory agencies defining parameters for growout, treatment, shipping, etc.

The Target Market

1. Demographic/geographic areas

Who are the target market consumers? Consider this beyond the distributor. Where do the end consumers live? Are they ethnic? What is their socio-economic status? Is it a growing segment of the economy? It is important to consider whom the distributor sells to, because that will determine the level of his potential sales, and therefore, the company's.

2. Lifestyle and psychographics

What is the socio-economic buying pattern of the end consumer? Are they convenience oriented? Is there a definite "lifestyle" associated with heavy users of the product? (For example, in predominately two-worker households, you might find many food products purchased because of convenience. An opposite case, with one stay at home adult, convenience may not be as important. Certain cultural groups may have different values placed on freshness, form, convenience, etc.)

3. Purchasing patterns

First, how does the distributor purchase the product? What size shipments does he prefer and how often? How does he distribute the product (time and place)?

Does the end consumer purchase the product daily, weekly, monthly or on special occasions? How much do they usually purchase at one time? What product form do they prefer?

4. Buying sensitivities

Is the end consumer extremely sensitive to price fluctuations? Is this product a staple or specialty product for the consumer? Do they view other species as substitutes for the product (which could allow much price sensitivity)? Are there any particular physical attributes to the product that target consumers prefer? (Examples are size, color, etc.)

5. Size and trends of market

In the particular market segment for the product, in your geographic target, how large is the market? How is it growing? Is it seasonal? Are there religious and/or other cultural celebrations that effect demand?

The Competition

1. Competitive position

How is the company positioned against competitors? What advantages does the company

have? What are the disadvantages and how will they be dealt with? How does the pricing and cost structure compare with the competition?

2. Market share distribution

What percentage of the target market does the company intend to acquire? How is this reasonable? What share does the competition have? How is it distributed among the companies?

3. Barriers to entry

Are there any significant barriers to entry to the target market? Are there contracts, agreements to purchase, etc. that would keep new competition out? Are there financial considerations that would effect new competitors? Are there regulatory issues that will effect the emergence of new competitors?

4. Future competition

What new competition is suspected in the target market in the future? Are there definite operations coming online? How will new competition be dealt with?

Marketing and Sales Strategy

1. The company "message"

What is the main thrust of the marketing plan? (For example: We intend to deliver "X" pounds of product on a bi-weekly basis of uniform quality and size product. This will make it easier on the large distributor as he will no longer have to deal with purchasing irregular amounts at irregular times from natural harvests or smaller suppliers.)

2. Marketing vehicles

How will the marketing message get out? Will conventional advertising, promotional mailers, personal sales visits, trade shows, etc. be used?

3. Strategic partnerships

Is the company involved directly as the only partner/supplier with a distributor(s)? Does this relationship make the market more secure? Are there existing sales contracts? If so, how will contingencies such as shortages, excessive mortality, etc. be dealt with?

4. Other marketing tactics

Will the company participate in promotional ventures? Is there a quality program that provides benefits/reassurances to the buyer? Are volume discounts offered?

5. Sales force and structure

What kind and size of sales force will be hired? How are they organized? How are their goals set and what incentives are provided?

6. Sales assumptions

Are there any particular assumptions related to sales in the business plan? Are there price assumptions? Competitive assumptions? How will management deal with divergence from stated assumptions if forced by market conditions?

Operations

1. Plant and facilities

Describe the physical plant and facilities. Include as an appendix, a floor plan for the facility. Describe the general geographical area of the plant. Give the operational address for the facility.

2. Production plan

How much of what product will be produced and at what time intervals? Describe initial stocking plans, harvest plans and expected mortality. Give a breakdown of time schedules for production.

3. Equipment and technology

What equipment will be used in the facility? How many tanks? What type of filtration system? How does the system work, in simplified terms? What type of redundant or back-up systems will be in place? What kind of alarm or warning system will be used? Is there documentation that can be provided on the technology and its successful use elsewhere? If so reference it to an appendix.

4. Variable labor requirements

What are the labor requirements? (This refers to non-managerial labor.) Does it vary seasonally? Is there adequate access to the types of labor needed? Will management “scale-up” labor during the start-up phase? (If so, provide an estimate of the time schedule for this.)

5. Inventory management

How will inventory be tracked? This will include the fish stock. This also includes inventory of expendable items such as salt, sodium bicarbonate, feed, etc.

6. Research and development

Will the company be conducting any research and development at the facility? This includes testing feeds, new species, water treatments, equipment, etc. Please explain management’s plans and why they will benefit the business. List any cooperating agencies, universities, and companies.

7. Quality control

How will the quality control system work? Is there a designated person in charge of this? If so, what are their qualifications for the position? What records will be kept regarding quality control? Is this in line with what the industry at large does?

8. Capacity utilization

What is the full capacity production limit for the facility? Will it be operating at that limit? Will the company scale up to that limit? If so, list milestones for reaching capacity. If the company is not going to be utilizing the facility to capacity, please explain why.

9. Safety, health and environmental concerns

Is the company in compliance with all regulatory agencies, including OSHA and EPA? What safety/health programs are in place to protect employees on the job? Will there be safety drills to deal with fire, contaminants, and other dangerous situations? (An example would be ozone usage.)

10. Management information systems

How will financial and operational records for your company be kept? Is the company computerized? Who has access/control over these systems? Are there adequate back-up procedures in place?

11. Other operational concerns

This is a “catch-all” category for anything that is not covered under one of the other topics. This is a good place to point out any operational advantages the company might have over competitors.

Management and Organization

1. Principals and key employees

List all the management and owners and summarize their expected contributions as well as their qualifications. List any key personnel and their contribution and qualifications. Reference current resumes in the appendix.

2. Board of directors

List all board members and explain why they are on the board. Explain any benefits obtained from having particular board members.

3. Consultants/specialists

List any consultants or specialists to be used during the course of operation. This will include accountants, attorneys, scientists, laboratories, etc. Explain the compensation plan. Explain what the duties of these consultants are and why they are vital to the business.

4. Management to be added

If management is to be added later, describe the position and function within the business.

5. Organizational chart

Include a reference to the appendix to a full organizational chart for your company.

6. Management style

What management style will be used? This can be from the informal “management by walking around” to a more formal directorial style? Explain the reporting system for regular and irregular operations. Explain proper response for operations irregularity.

Development and Exit plans

1. Long term company goals

What are the long term goals of the company? Is it expected to vertically or horizontally integrate or expand production into other facilities?

2. Growth strategy

What is the growth strategy and how will it be managed and financed?

3. Milestones

Provide a narrative and chart pointing out major milestones in the development of the company. This includes pre-groundbreaking time, plan writing time, etc.

4. Risk evaluation

What type of model will be used to evaluate risk of continued operations? What type of model will be used to evaluate risk of expanding operations? (This can be as simple as a SWOT analysis combined with financial spreadsheet sensitivity analysis or as complex as a statistical risk assessment.)

5. Exit plan

What are the criteria/procedure for voluntarily shutting down the business?

Financial Statements

1. Cash flow statement

The cash flow statement is the easiest and most important of all financial statements. It is

a direct statement of cash (revenues) in less cashes (expenses) out, leaving cash on hand. This is an important managerial statement. It is the record of (for historical or real statements) the ability to meet financial obligations and the forecast of ability to meet potential obligations..

2. Income statement

The income statement is a statement of profitability, not of cash left on hand as in a cash flow statement. The major difference is the inclusion of non-cash items such as depreciation and other non-cash adjustments. The income statement should be prepared on the same schedule as the cash flow statement.

3. Balance sheet

Many investors and lenders are interested in the balance sheet. Basically the balance sheet is a statement detailing assets, liabilities and owner's equity. The basic mathematical structure of the balance sheet is simple: assets equal liabilities plus owner's equity. This is normally prepared annually, but in start-up phases, lenders may like to see the statement quarterly.

4. Break even and other analyses

Perform analysis on your financial statements to ascertain the financial health of the business. Also, financial institutions will analyze the statements. Some analysis should be presented in the business plan. These are some of the more relevant ones.

a. break even analysis

b. liquidity ratios

current ratio = current assets / current liabilities

quick ratio = (current assets - inventory) / current liabilities

c. leverage ratios

debt to assets = total debt / total assets

times interest earned = earnings before interest and taxes / interest charges

d. activity ratios

inventory turnover = sales / inventory

fixed assets turnover = sales / net fixed assets

total assets turnover = sales / total assets

e. profitability ratios

profit margin = net income / sales

basic earning power = earnings before interest and taxes / total assets

return on total assets = net income / total assets

return on equity = net income / equity

5. Plan assumptions

List any assumptions that went into making the plan. Include areas such as funding, potential employees, etc. There should be a separate list of assumptions/explanations for all line items on the financial statements.

Appendix

This section will include all items too detailed for the body of the plan or items that do not fit any particular category. Any items referenced in the body (such as resumes, explanations of terms, contracts, etc.) should appear here. Letters of intent to purchase, supply consult, or assist belong here, after being referenced in the main text. Any other documentation requested by investors or lenders may be referenced and placed here. If the appendix is lengthy, it is often preferable to give it its own sub-table of contents.