

FINANCING OPTIONS

Every startup business has the problem of where they will get the money for the initial period in the life of their new business. Most entrepreneurs have limited resources, unlimited dreams and only an exposure to finance as an individual for a mortgage, etc.

The first step in financing a business is to do a realistic “Source and Application of Funds” statement as part of every business plan. If this is not done before you start, you will be constantly underfunded. It might look like this:

Start-Up REQUIREMENTS-

Opening day cash balance	\$15,000
Inventory of merchandise	15,000
Equipment	15,000
Organizing/Pre-opening exp	5,000
Personal salary till BIZ can pay	15,000
Losses to Break-Even Point	<u>35,000</u>
Total Funding Needed	\$100,000



Start-Up SOURCES of Funding-

Owner’s Equity paid in	\$ 5,000
Owner’s Equity equipment	<u>15,000</u>
Initial Equity	\$20,000
Debt Capital-	
Owner loan	5,000
Relatives	10,000
Vendor’s consignment	5,000
Bank loan	<u>60,000</u>
Total Sources of Funds	\$100,000

So what are the **alternatives** to fund a start-up business? It will vary but the following list will give the new entrepreneur resources to research:

1. Owner’s personal cash and investments

The owner will be expected by the bank and others to put themselves at risk before they commit their resources. Lenders expect 20-30% to come from the owners themselves. The tight credit market since 2008 may change these.

2. Owner’s credit card limits that are unused

This source is used to frequently. OK when the needs are small and temporary. High interest rates if balances are carried for extended periods of time.

3. Owner's title to non-cash assets

Evaluate what assets exist that should be transferred to the business as part of the owner's original equity, such as equipment, patents, copyrighted works, and assets previously paid for by the owner, etc.

4. Home equity values

Assess the market value of your home versus your mortgage to see if some part of the equity can be used as temporary working capital or long-term investment.

5. The 3 F's resource – Family, Friends and Fools

Can be good but can be dangerous depending on the loan conditions, the time until your business breaks-even and begins funding itself. Check whether you know anyone in this category with money.

6. Borrow against future inheritance

Your parents may be willing to 'advance funds' from their estate to an heir. You should have other sibling's approval to avoid future conflict.

7. Bank loans

Normally any short fall between start-up needs and funds available will be provided by a banker. Start with your current banker where you have a history, even if that history has been shaky. They normally want to review a Business Plan and normally will not fund the entire start-up needs and expect some level of owner investment (this will vary with the lender, business prospects and their assessment of the six C's of credit listed below:

A SCORE "Going Into Business" workshop would discuss these in more depth.

Character

Your integrity
Your track record



Collateral

Business assets
Personal assets (pledged for the business)

Capacity

Managerial
Financial

Communications

Regular financial updates
NO surprises in relationship

Capital

Net equity of business
Debt to equity ratio

Conditions

Local & national economic outlook
Loan terms

8. **Admit Members/Issue Stock.** At some point you may need to increase the ownership in your company. As an LLC you may add members for a skill they can bring to the business or assets they can invest. As an S Corp or C Corp, you have the option of issuing addition shares of stock in the entity. Be "careful" that in using this option, you do not give up your control. Retain at least 51% so that the business does not suffer due to inaction or a 50/50 stalemate.

9. **SBA guaranty** to get a bank loan

A lender may feel your loan request is too risky and suggest a SBA Guaranteed Loan (the SBA does not make loans but for a fee guarantees a portion of a lender's risk). Go to



<http://www.sba.gov/services/financialassistance/index.html> to play a tutorial on lending and SBA's role. Generally a SBA guaranteed loan may be for a building, equipment, refinancing or buying a business. They may have a maturity of 7-25 years. The interest rate is a minimum of 2.5% over prime for which the bank receives a 75-85% loan guarantee.

The SBA also charges a fee of 2% of the loan balance so this alternative is not cheap, but may be your only recourse to get a bank loan. They also have a Micro Loan program for amounts under \$35,000 which are offered through community development intermediaries.

10. **IRA/401K accounts**

One asset a business owner may have but hesitate to use because of early withdrawal penalties and risk to their future retirement is the funds in a retirement account. There is a provision in the Federal ERISA Act that allows an IRA/401K account to invest in stock of a C Corporation (you).

This moves the funds from the IRA/401K account into your company's checking account. You can then use the funds for start-up expenses, salaries, etc. There are fees involved to set up a new retirement account, set up the tax shelter, file the state reports, etc. This is not a do-it-yourself process. You need an attorney to do act for you. One resource is www.benetrends.com.

How the Process Flows



11. **Crowd Funding.** This is a new source of funds that will become available early in 2013. The JOBS act of 2012 authorizes small business to raise up to \$1 million dollars in any twelve month period. The Securities Exchange Commission will issue regulations in 2013 allowing small businesses to receive money for a projects, products or a program. Here is how it is expected to work:
- a. Entrepreneur posts business plan and Equity Offer on registered crowdfunding portals, like, Kickstarter, Indiegogo, Fundable, etc.
 - b. Internet Crowd sees the offer and evaluates it.
 - c. Crowd pledges money which is held in escrow temporarily
 - d. If Offer is fully funded, the money is transferred to the entrepreneur
 - e. Entrepreneur transfers stock to the Crowd thru a Transfer Agent
 - f. Entrepreneur continues to report to crowd Shareholders.
- See the website: National CrowdFunding Association for the latest status.

Really IFFY Alternatives or Reality Check

12. Government grants

There are some government grants available for certain endeavors and to certain people. They are hard to find and qualify for. Research these links for chances:

<http://www.sba.gov/services/financialassistance/grants/index.html>

13. Venture capitalists

This is a type of private equity capital provided by professional outside investors for third parties to new high-potential growth companies, usually in hopes of taking the company public through an IPO. They review many deals to make a few investments which are in cash in exchange for stock and may include managerial and technical advise. The VC's may be groups, a fund (like a Hedge Fund) or an individual. Traditional VC's do not consider investments under \$1-2 million. The downside for a new business entrepreneur is that VC's usually get a say in company decisions plus a portion of the equity, if not a controlling interest!

14. Financial 'Angels'

Angels typically invest their own funds and reflect the judgment of a individual although the entity providing the funds may be a trust, LLC or investment fund.

To tap this resource you should belong to the right clubs and know the right 'movers' in your community. A national organization can be researched at:

<http://www.angelcapitalassociation.org/>. Angels may fill the gap between the 3 F's above and the Venture Capitalists.

In 2006, angels provided \$25 billion in funding versus \$26 billion for VC's, but, they invested in 51,000 companies versus only 3,522 for VC's. Most angel investments go for healthcare services, medical devices, software and biotech.

Statistics from: http://wsbe.unh.edu/Centers_CVR/2006pressrelease.cfm

15. State lottery

You may have to put your dreams on hold until your ticket wins. If you are willing to wager a little amount with a chance to win a large amount...then this may be your salvation. "Simply put, it costs little to dream big, and you can't win if you don't play." But owning your own business to get rich slow is a better bet.

16. Unknown donor from the Republic of Benin

Notices of unknown inheritances are regularly announced via unsolicited email. Maybe your spam is the only resource left if you get to this point.

In summary this slide may put this reference document in perspective:

END

Cash flow, cash flow, cash flow

- Gotta have it.
 - Start up funds
 - Fund operations
- Gotta find it.
 - Personal investment
 - Outside financing
- Gotta keep it coming...
 - Sales
 - Business growth

