How to Finance your Startup

THE LEGAL STUFF

You may forward this ebook in its entirety without alterations to anyone you wish or download a copy from the MoreBusiness.com web site at www.morebusiness.com. Feel free to post a note about how to download this ebook for free on your blog or web site.

That said, there are a few things to note about the copyright:

This book may not be reproduced in any form without the prior written permission of the publisher except in the case of brief quotations in critical articles or reviews. Copying any part of this book for any purpose other than your own personal use is a violation of United States copyright law.

This book is provided or sold as is, without any warranty of any kind, either express or implied, respecting the contents of this book, including but not limited to implied warranties for the book's quality, performance, merchantability, or fitness for any purpose. Neither the author nor the publisher and its dealers and distributors shall be liable to the reader or purchaser or any other person or entity with respect to liability, loss, or damage caused or alleged to have been caused directly or indirectly by this book.

Trademark and service mark terms used in this book are the property of the trademark holders. Use of a term in this book should not be regarded as affecting the validity of any trademark or service mark.

Published by Khera Communications, Inc., owners of MoreBusiness.com
Rockville, Maryland, USA

CONTENTS

1

CHAPTER 1: ALL FINANCING IS NOT CREATED EQUAL

Learning how to get cash in hand to start your business begins with understanding that **all financing is NOT created equal**.

You have an innovative idea, a great business plan, as well as a team of dedicated and talented support staff in place. You've conducted the necessary research and organized all your ducks in a row. This is all part of what it takes to lay the ground work for a successful start-up venture. The next critical step is securing the appropriate financing for your business venture.

New business financing can be complicated, and there are a variety of approaches one can take, as well as a number of factors that can influence success. As you start a new business, exploring the pros and cons of various financing options is critical. Rather than settling for the first available option that comes your way, take time to get to know the different facets of start-up venture financing. This guide contains comprehensive information regarding the many options that exist for financing your start-up venture and great tips that will help you make an educated, lucrative decision.

Learning how to get cash in hand to start your business begins with understanding that all financing is NOT created equal. There is more than one way to finance a venture, and several fundamental factors come into play when it comes to choosing the best option.

DEBT VS. EQUITY: THE GREAT FINANCING DEBATE

At its very core, there are fundamentally two ways for a new business to generate start-up funding: accrue debt or relinquish equity.

At its very core, there are fundamentally two ways for a new business to generate start-up funding: accrue debt or relinquish equity. With debt financing, you can take on loans that must be repaid with interest to finance your start-up. Or you can secure equity financing, wherein you technically do not pay back the monetary funds, but will be required to relinquish both an ownership and controlling stake in your company. The fundamental differences between equity and debt financing include:

EQUITY FINANCING	DEBT FINANCING
The funding does not need to be paid back in monetary terms.	The loan must be paid back to the financial institution.
Interest does not accrue, and there are no regular monthly payments. However, you may need to pay dividends from retained earnings.	The loan comes with the burden of interest expense, and you must meet the regular loan payments.
While no collateral is needed, you will forfeit a certain percentage of ownership and control.	You may be required to provide collateral to secure the loan. However, you do not relinquish any control or ownership shares.
While you will pay dividends, these costs are not tax-deductible.	The interest cost is tax-deductible.

DEBT VS. EQUITY: THE GREAT FINANCING DEBATE

At a cursory glance, it may appear that equity financing is more attractive. After all, there are no regular payments or interest costs to bear. While novice entrepreneurs may like the concept of "free money" from equity financing, the costs are high—including giving up a portion of your ownership and control. You may not have monetary costs like the ones associated with debt financing, but equity financing will "cost" you nonetheless in ownership and controllership.

THE VALUE OF OWNERSHIP

When examining financing options for a start-up venture, it is important to consider the facets of ownership. Ask yourself some of the following questions:

- Do I want to become a sole owner or sole proprietor and take on full ownership responsibilities?
- Do I have relationships with friends, family or business professionals who may be financially capable of financing part or all of the venture?
- If I choose a shared ownership option, will I be financially stable and capable of buying my partner's share of the business in the future to assume full ownership?
- Am I comfortable relinquishing a large part of my ownership in exchange for major venture capital financing?

In the business world, the term "ownership" refers to the person who has put financial capital into the venture and will therefore collect the profits. A venture many have one or more owners with equal or unequal stakes in financing. For example, if you come to the table prepared to put up 50% of the start-up costs from your pocket, you might solicit a friend, family member or business partner to put up the other 50%. That individual who provides the other 50% of the financing will share in equal ownership of the venture with you.

If you want to exercise more control over the ownership of your company, there are other creative ways that you can address issues up front. Take what Louis Meeks, the founder of a company called The Service Source, did. Meeks created a buyout agreement with his cofounder and a lawyer before the business started. It contained certain rules regarding what each cofounder could or could not do with their portion of the business if they wanted out. This is a great way to protect the ownership of your business, no matter what financing option you choose.

Because ownership ultimately dictates and profits—and essentially the return on one's personal investment—it is not possible to consider financing options without first exploring how ownership of the business will be handled. Ownership and start-up venture financing have a unique and interdependent relationship. You need to decide what your aspirations and goals are with regards to business ownership prior to choosing an approach to financing.

THE COST CONTROL

When examining financing options for a start-up venture, it is important to consider the facets of controllership. Ask yourself some of the following questions:

- Do I have the knowledge and expertise to serve as full or partial owner and controller?
- Do I have a trusted friend, family member or colleague who is capable of assuming controllership?
- What differences will occur in relation to profit distribution and sharing if I delegate controllership to another party?
- If I allow a venture capital firm to fund my business, how much of the controlling rights am I comfortable giving up?

Like ownership, control of the business is another factor that will influence financing decisions. The controller of the business is the person that makes the management decisions. Sometimes the owner will also assume the role and responsibility of controlling the venture. Other times ownership and control are separated into the hands of two or more different people. If you opt for venture capital financing, then you will relinquish a significant amount of control to the VC firm. The envisioned structure that you have designed for your start-up venture will help you to determine the approach to control, as well as the relationship between ownership and control.

For example, if you have taken out a small business loan under your own means to finance a venture, and you have the know-how to manage and operate the business, the odds are likely that you will be a sole business owner with the added responsibility of controlling the venture. On the contrary, if you provide 50% of the financing, your brother provides the other 50%, and you hire an experienced colleague that you met in graduate school to serve as the manager of the business, you have shifted the responsibility of part ownership to your brother and the controlling responsibilities to your colleague.

While some financing methods may not influence controllership, others, such as venture capital, can dramatically change how much control you exert over your business. Because controllership is a very hands-on aspect of the business that will ultimately impact profits, it is important to carefully weigh options about who will take on the responsibility of controlling the business.

STRATEGIC PLANNING

Remember that ownership and control will impact the overall operation of your business. If you choose to look for investors, then you must consider how those investors will impact your goals and dreams for ownership and control.

For example, if you allow investors to serve as members of your company's board of directors, there are certain risks. The board of directors will have the responsibility of caring for the financial and legal matters associated with the company. An investor will be able to exercise significant control over your business if allowed to serve as a member of the board of directors – and this decision is one that you cannot take lightly.

It is important to carefully plan to address (or avoid) such details well in advance because they will impact ownership and control of your business. Once you have determined a balanced strategy and execution for ownership and controllership of your start-up venture, you can then take a more objective and critical look at the many different financing options that are available.

WORKSHEET: SHOW WHAT YOU KNOW

Before exploring the different financing options that are available for a start-up venture, it is important to demonstrate an understanding that all financing is not created equal. Use the following quiz to assess your understanding of debt, equity, ownership and controllership (answers are included at the end of the exercise):

1. Equity financing is better than debt financing because there are no actual costs for the entrepreneur.
   ❑ True ❑ False

2. Debt financing has no interest and no monthly payments.
   ❑ True ❑ False

3. The business owner(s) take on significant financial risks, therefore the owner(s) collect on any profits.
   ❑ True ❑ False

4. Under all circumstances, the owner assumes full control over the business.
   ❑ True ❑ False

5. Investors do not have any control over business decisions.
   ❑ True ❑ False

Now that you have mastered the basic concepts of debt, equity, ownership and controllership, it's time to start exploring the different financing options that are available for your start-up venture.

Answers

False. Equity financing comes at a cost to the entrepreneur. Depending on the terms, the entrepreneur may have to relinquish some ownership of the business.

False. Debt financing requires both monthly payments and accrues interest.

True.

False. The owner does not always assume full control. Controllership may be passed on to a business partner or hired manager.

False. Investors may exercise control over important business decisions of they are allowed to serve on the company's board of directors.

2

CHAPTER 2: PERSONAL FINANCING

Using personal financing for a start-up venture is one of the least complex funding options; however, it is also one that poses the greatest number of risks. Personal financing for a start-up venture consists of any of the following options:

- Using personal savings to start the business.
- Borrowing money from friends, family or colleagues to start the business.
- Using a personal line of credit and/or credit cards to start the business.

Each one of these options has unique factors that can be positive or negative for a start-up venture.

THE PROS AND CONS OF PERSONAL FINANCING

Exercise caution when considering people with whom you have close relationships as potential investors.

With personal financing, **there is no insurance policy or protection** if the business is not viable or profitable.

Personal financing at the grassroots level involves bootstrapping and tapping into your own accounts for start-up capital. This could be a savings account, retirement account or thrift savings plan. The advantage of this method is that you can exercise complete ownership and controllership since you will be the sole investor. A danger of using personal funds to finance a start-up venture is that you may lose the money you worked so hard to earn. With personal financing, there is no insurance policy or protection if the business is not viable or profitable.

Putting your own money on the line for the sake of a start-up venture is not nearly as risky as involving the financial interests of friends, family or colleagues. When other peoples' funds are on the line, maintaining healthy relationships becomes a challenge. Exercise caution when considering people with whom you have close relationships as potential investors. You will want to work with individuals who are flexible, adaptable and teachable. If there is a danger or history of unresolved conflict between any parties, chances are that a personal financing arrangement could turn sour.

BEAR NAKED GRANOLA: A PERSONAL FINANCING SUCCESS STORY

Despite its many dangers, personal financing doesn't always go awry. For example, the ambitions and personal savings of entrepreneur Kelly Flatley led to her development of a multimillion dollar business idea. Flatley—a health and fitness enthusiast—wanted to market and sell a unique, natural granola product. She developed a recipe and then used her own savings to rent a commercial kitchen where she mass-produced her granola at night. Then she delivered the products herself to local grocery stores and health food shops. After partnering with another savvy entrepreneur, Brendan Synnott, Flatley decided to go big with Bear Naked Granola. The business partners went on to sell their idea to Kellogg for about $60 million.

Flatley's story is evidence that with careful planning, tact and diplomacy, personal financing can and does work in some start-up ventures. It may be helpful to study the financing techniques of other start-up ventures that are similar in size and scope to your plan.

CREDIT CARD FINANCING: HOW INTELLIGENT IS THIS OPTION?

Establishing a line of credit or taking out a loan is yet another personal financing option. While bank loans will be discussed in depth in Chapter 3, when a new business opens its doors, banks will often require that the entrepreneur offer up a personal guarantee. This means that the individual will be responsible for the balance due on the loan, even if the account is secured in the business name. The economic recession and ongoing financial crisis have limited the number of loans and lines of credit that banks extend to small business owners and start-up ventures.

A fast and easy solution to accessing funds that aren't readily available is credit cards. Credit cards are relatively easy to obtain, either in the name of the individual or the business. They offer fast financial solution to aspiring entrepreneurs who do not have cash in hand or investors.

Unfortunately, interest rates on credit cards are typically much higher than that of a traditional loan. Because most credit card companies will also require a personal guarantee on all accounts, the business owner assumes responsibility for all monies owed. In the event that the business owner defaults on payments, this will have a negative impact on their personal credit score. Weigh the costs and benefits of personal financing through credit cards carefully before opening an account. The long-term effects of an outstanding credit card debt are detrimental for entrepreneurs in the long run.

Just like all financing is not created equal, all personal financing is not even created equal. Whether you choose to explore the possibility of using your own savings, soliciting help from friends, family or colleagues, or using a credit card, personal financing must be carefully considered from all angles.

WORKSHEET: ASSESS YOUR POTENTIAL FOR SUCCESS

If you are considering personal financing as an option, then you will want to perform a self-assessment to determine your readiness for using this strategy for your start-up venture. Use the following quiz to assess the potential for using personal financing:

1. I have a comfortable savings account value and backup financing for my personal expenses should things turn sour with my business venture.
   ❑ Yes ❑ No

2. I have strong relationships with the friends/family/colleagues I am considering as potential investors.
   ❑ Yes ❑ No

3. In the past, I have been able to successfully resolve conflict and/or solve difficult problems with the friends/family/colleagues I am considering as potential investors.
   ❑ Yes ❑ No

4. My personal credit history is impeccable, and I have a backup plan to make payments should things turn sour with my business venture.
   ❑ Yes ❑ No

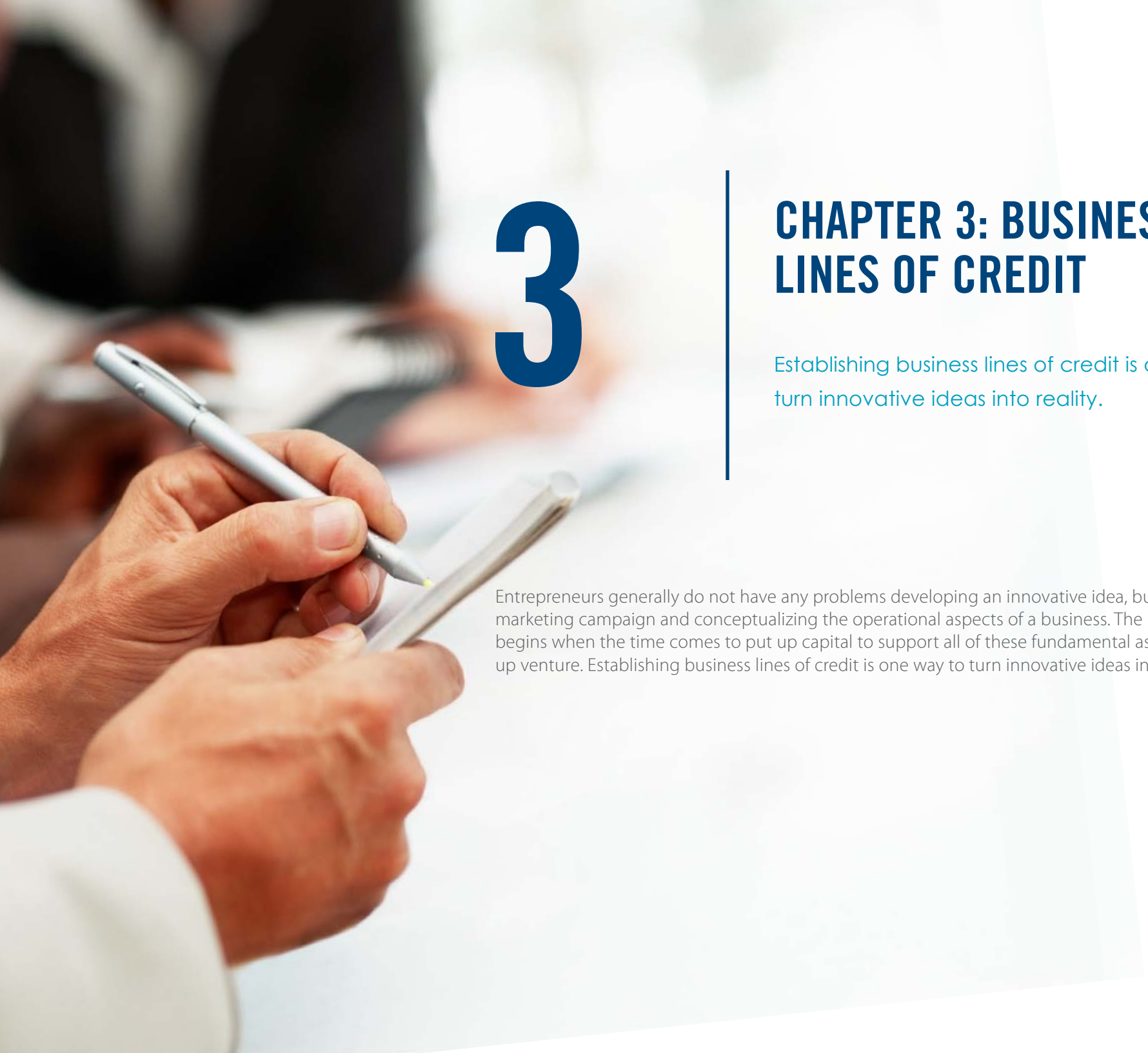
5. I am willing to risk my personal savings and/or my relationships with friends/family/colleagues in order to accomplish my entrepreneurial goals.
   ❑ Yes ❑ No

Add the total number of "yes" responses to the previous questions and use the following guide to determine your potential with personal financing:

0 to 1. Your potential for success with personal financing is low. Take steps to start building and reinforcing your personal savings and/or relationships with friends, family and colleagues before considering this option.

2 to 3. Your potential for success with personal financing is moderate. Take steps to develop backup plans and accrue additional savings to be used in the event that the business venture does not work out.

3 or More. Your potential for success with personal financing is high. Revise and revisit your backup plans and open lines of communication with potential friends, family and colleagues if applicable.



3

CHAPTER 3: BUSINESS LINES OF CREDIT

Establishing business lines of credit is one way to turn innovative ideas into reality.

Entrepreneurs generally do not have any problems developing an innovative idea, business plan, marketing campaign and conceptualizing the operational aspects of a business. The real trouble begins when the time comes to put up capital to support all of these fundamental aspects of a start-up venture. Establishing business lines of credit is one way to turn innovative ideas into reality.

TIERS OF BUSINESS CREDIT

Tier 1: Business or Trade Credit
Tier 2: Advanced Trade Credit
Tier 3: Bank Lending
Tier 4: Private Equity Investors

For entrepreneurs with dreams of financing a start-up venture, there are four different types of business credit. Some businesses are better off with choosing only one tier, while others may benefit from dabbling in two tiers. Each of the financing tiers has special features. The following details will help you determine which one is best for your venture:

Tier 1: Business or trade credit is extended from a company to an entrepreneur without a business or personal credit check. Common forms of tier 1 credit include "net 30" terms, which are particularly helpful for companies who need to purchase physical products wholesale. Tier 1 credit is generally intended for use by a corporation that has already established a certain relationship with a supplier. This tier features the greatest source of capital in the world for businesses.

Tier 2: Advanced trade credit is similar to tier 1 in that it involves one company extending a line of credit to another. The difference in tier 2 is that an extensive business credit check will be performed. Often times, tier 2 credit is used to purchase expensive equipment or supplies that are manufactured by another company. In some tier 2 relationships, the parties develop very large lines of credit, as well as lengthy payment terms.

Tier 3: Bank lending is the most popular way to approach business financing. Both banks and credit card companies perform this type of lending. After a personal and business credit check, the financial institution extends a line of credit – often a limited amount to start with – to the business owner. The amount of credit made available is a direct result of credit history. To secure a larger line of credit, a detailed business plan is absolutely necessary.

TIERS OF BUSINESS CREDIT

Tier 4: Private equity investors, although not strictly categorized as "lenders" of lines of credit, do fuel a significant amount of startups. Private equity financing, which technically does not need to be "paid" back through monthly loan payments, will be discussed in later chapters, but as an overview, these investors are unattached to any bank or credit card company. In tier 4, the funding for a start-up venture comes from a private investor, a venture capitalist or an angel investor. This is one of the most complex financing options. Competition is fierce when it comes to tier 4 financing, and entrepreneurs with both industry experience and an innovative, high-growth idea stand the best chance of capturing private equity financing.

THE PROS AND CONS OF BUSINESS CREDIT

Keep in mind that you can use a combination of different methods and solutions to finance a business venture.

Each tier of business credit financing has its pros and cons. Tier 1 is ideal for businesses that have already established a relationship with another company that grants business credit. While startups rarely have existing relationships with suppliers, you can easily develop a rapport that will translate into tier 1 credit. Begin by placing small orders and paying immediately. Once you have made several small purchases, inquire about "net 30" terms, using your existing relationship as leverage.

Tier 2 is ideal for companies that have a solid credit history and those looking to engage in a long-term relationship with another company that grants large business lines of credit.

Tier 3 is the perfect solution for newer or underdeveloped companies that are just getting off the ground and have yet to establish a lengthy credit history. Unfortunately, the interest rates of tier 3 loans tend to be higher, the lines of credit shorter, and the terms more restrictive.

Unique from tiers 1 to 3, tier 4 is especially appropriate for cutting-edge ideas that will generate an interest from investors who want to take risks that have the potential of generating high returns. While we will discuss private equity financing in detail in the next chapters, for certain industries, like health, energy, science and technology, tier 4 offers a great deal of promise for entrepreneurs who have a high-growth idea.

Some tiers of financing are certainly more practical for start-up ventures. Aside from personal financing as discussed in chapter two, bank lending is the most popular choice for entrepreneurs. Keep in mind that you can use a combination of different methods and solutions to finance a business venture.

SUCCESS STORY: FROM BANK LOANS TO SELLING PITA CHIPS FOR $1.3 MILLION ANNUALLY

Stacy's Pita Chip Co. started in humble quarters in 1998, renting space at the Boston Pretzel Bakery during the bakery's downtime. Although neither of the founders, Mark or Stacy Andrus, had a business track record, they did possess two items that made their loan application interesting to Fleet Bank: a solid business plan, as well as a letter from an airline executive that stated their company would easily purchase 1,000,000 pita bag chips if Stacy's could manufacture them.

With a $300,000 loan in hand, the company grew from one outdated foot-pedaled sealing machine and $25,000 in annual profits to reaching more than $1.3 million in yearly revenues. Stacy's Pita Chips are now found across the country in 37 different states in major chains, including Shaw's, Stop & Shop, and private labeled through Trader Joe's.

WORKSHEET: ASSESS YOUR POTENTIAL FOR SUCCESS

The different types of business lines of credit can be confusing. Choosing the right one is critical for success in your start-up venture. Use the following tool to assess your potential for the various business lines of credit:

1. I have taken the time to develop a strategic business plan, complete with detailed financials and projections.
   ❑ Yes ❑ No

2. I have already opened some smaller lines of credit and have begun to build a credit history in the name of my business.
   ❑ Yes ❑ No

3. My business AND personal credit histories are strong and long.
   ❑ Yes ❑ No

4. I have had serious conversations with potential investors, companies that grant business lines of credit, and/or vendors/customers that have expressed interest in my business.
   ❑ Yes ❑ No

5. My business is poised to accomplish innovation. I believe it has the potential to become an industry leader.
   ❑ Yes ❑ No

Add the total number of "yes" responses to the previous questions and use the following guide to determine your potential with business lines of credit:

0 to 1. Continue exploring the possibility of personal financing options and tier 3 lines of credit. Work on developing a more comprehensive business plan.

2 to 3. Explore the possibility of using tiers 2 and 3 for business lines of credit. Work on developing a more comprehensive business plan.

3 or More. You are positioned for some flexibility with finance options. Explore tiers 1-4, and tweak your business plan accordingly.

4

CHAPTER 4: CREATIVE FINANCING OPTIONS

Thinking outside of the box—even tapping your current employer or existing customers—can help you creatively secure funding for your start-up venture.

Traditional tier financing has been fueling the business world for decades, but these options are not the only ones available. Thinking outside of the box—even tapping your current employer or existing customers—can help you creatively secure funding for your start-up venture. Savvy entrepreneurs have developed very creative ways to pique the interest of other companies and even individuals who have a surplus of wealth.

THE ADVANTAGE OF COMPETITION (LEVERAGING YOUR CURRENT EMPLOYER)

Your **current employer** may be motivated to invest in a start-up venture given the right conditions.

Personal funding can come through another unique avenue besides your savings account, friends, family or colleagues. Your current employer may be motivated to invest in a start-up venture given the right conditions. If you work in a moderate to large organization and have an entrepreneurial spirit, chances are that the company may want to take an equity interest in your venture, rather than lose you and write your innovative ideas off as a loss.

Sometimes employers recognize an excellent idea when they see it. It is better to join forces with you than be subject to missing out on revenues when you and your start-up venture become the competition. Obtaining personal funding through equity in this manner can be a complex process, but it is more safe and secure than going it alone or putting personal relationships on the line.

CUSTOMERS AND VENDORS

Vendors, suppliers and customers possess a wealth of capital that may prove beneficial for a start-up venture.

In addition to the four traditional tiers of business financing, there are some other unique financing sources that are often times overlooked by entrepreneurs. Vendors, suppliers and customers possess a wealth of capital that may prove beneficial for a start-up venture.

Vendors & Suppliers – Sometimes the vendors and suppliers that have already partnered with a company will put up financing under the terms that their products will be used in the new business. This type of financing usually comes in the form of a simple loan, and there are options to negotiate on terms like interest rates and payments. This creates a win-win situation for the entrepreneur and investor, sometimes resulting in long-lasting business relationships.

Customers – Few entrepreneurs think to tap into the power of the customers that keep the business running in the first place. Sometimes a customer will take an interest in the business operation and contribute to the development of a product if it is innovative and creative – and will help the customer's business. The customer has a unique perspective in that they understand what products are necessary in the market.

Both vendors and customers may be willing to put up financing for a venture if they benefit directly from the business development initiatives. For example, if your business is developing or producing a product that the vendor or customer needs in large quantities, they may be willing to provide financing in exchanged for perks like discounted pricing on the final products or partial equity. These relationships can be tricky to develop, but in the end they are usually win-win for customer/vendor and entrepreneur.

SUCCESS STORY: CUSTOMERS AS INVESTORS

While using customers, vendors or suppliers as investors is not a traditional approach to business financing, it does work in some cases. Beyond stumbling across a generous vendor or a wealthy customer, there are other creative ways to use the buying power of customers to financing. Take the east coast bakery that used an intriguing instrument called "Sweet Bonds" to finance an investment in new kitchen equipment, for example. When the owner was turned down for a loan from her bank, she went to customers with a different solution.

The owner started selling Sweet Bonds, which were essentially coupon booklets valued at $125 and good for one year at a discounted rate of $100. The entrepreneur got cash in hand up front for sales to be made in the future. She sold enough Sweet Bonds to purchase new kitchen equipment, develop better products and satisfy her customers. This is just one example of creative ideas customers can use to fund a business financing endeavor.

WORKSHEET: ASSESS YOUR POTENTIAL SUCCESS

Depending on the types of business relationships you have already developed, you may be able to come up with some creative solutions for business financing. Use the following worksheet to assess your potential for success:

1. I have already explored traditional options like business lines of credit and personal financing for my business endeavor to no avail.
   ❑ Yes ❑ No

2. I already have strong, healthy relationships with one or more customers who are business-minded and affluent.
   ❑ Yes ❑ No

3. My company does or is planning to do high volumes of transactions with one or more major vendors/suppliers. I already have an existing relationship with the vendor/supplier.
   ❑ Yes ❑ No

4. I need to raise capital quickly in order to implement a business development initiative. The projected numbers for the plan show potential for growth.
   ❑ Yes ❑ No

5. My business already has a strong reputation in the community.
   ❑ Yes ❑ No

Add the total number of "yes" responses to the previous questions and use the following guide to determine your potential with business lines of credit:

0 to 1. Refer back to other more traditional financing options.

2 to 3. Work on building more relationships with customers, vendors and/or suppliers.

3 or More. You are positioned for an innovative and creative financing solution.

5

CHAPTER 5: INSTITUTIONAL BANK LENDING AND SBA LOANS

If you have discovered that personal financing and the four traditional tier options aren't the right solution for your small business venture, there is hope. There are some start-up financing options with unique features that are geared specifically toward helping small businesses. It is possible to obtain financing through a special partnership between banking institutions, the United States government and the Small Business Association (SBA). Through the SBA, the government has taken measure to guarantee financing that is extended through large banks. Major financial institutions like Bank of America and Citi offer these types of loans.

Qualified applicants for such loans include for-profit businesses that are owner-operated and demonstrate an inability to secure financing under the traditional terms already outlined in this eBook. Other criteria include that the business must be set up as a sole proprietorship, corporation or professional partnership. Finally, the business must also be within certain size requirements that are outlined specifically by the SBA. These size requirements vary across industries.

Institutional bank lending backed by the SBA is an excellent option for start-up ventures that meet these qualifications. In addition, there are two different types of loans available with special features and perks.

TYPES OF BANK/SBA LOANS

Type 1: Traditional Loan

Type 2: Patriot Bank/SBA Loan

There are two primary types of bank/SBA loans. The first is a traditional loan that requires applicants to meet the basic criteria as outlined above. In its simplest form, qualified applicants are eligible for a traditional bank/SBA loan that features a competitive interest rate, flexible repayment terms and a full government guarantee for repayment in the event that the venture does not prosper.

The second type of loan is a patriot bank/SBA loan, which is reserved for individuals who are veterans, active duty military members, members of the military reserves or National Guard, as well as spouses of any of these different groups. In the event that a business is set up as a partnership, it is still possible to qualify for a patriot loan provided that at least 51% of the business is owned by a member of one of these groups.

Obtaining either type of bank/SBA loan require a solid business plan, financial statements, some collateral and a detailed repayment plan.

BENEFITS OF A BANK/SBA LOAN

Bank loans backed by the SBA provide a high degree of personal and professional security for start-up ventures because they are guaranteed by the United States government.

There are many benefits for business owners who choose to start up with a bank/SBA loan. Bank loans backed by the SBA provide a high degree of personal and professional security for start-up ventures because they are guaranteed by the United States government. Failure to repay does not mean financial ruin in this case. This is one of very few financing options that features such security for the business owner(s)' personal credit history and business credit. Bank/SBA loans are offered at such reasonable interest rates that repayment terms are manageable, even if the business struggles to get off its feet initially.

SBA/bank loans are also flexible in terms of how the funds can be used. From performing renovations on a building to purchasing new equipment or simply covering ongoing financial needs, these loans are not as restrictive as other financing options when it comes to making actual expenditures.

The repayment terms are more flexible, and the bank is often times willing to negotiate much longer loan terms. This means that monthly payments will be lower, and the business can concentrate more actively on development initiatives. It is also not necessary to have a long credit history or a pristine credit score in order to obtain a bank/SBA loan.

PITFALLS OF A BANK/SBA LOAN

Like any financing option, there are certain pitfalls associated with bank/SBA loans. The criteria to qualify for a bank/SBA loan are stringent. There are no loopholes that will allow a start-up venture to slip through and obtain funding. Some aspiring business owners may discover that their business plan does not align with the requirements of bank/SBA loans. This means that changes must be made or an alternative financing solution must be sought.

All entrepreneurs who choose to use a bank/SBA loan will also be responsible for paying certain fees to the SBA. This serves to cover the costs associated with the government guarantee and administrative duties. It is an added cost that is not associated with personal financing or the four traditional tiers of business credit.

Because the loan term and payment options are so flexible, there is a certain level of risk associated with a bank/SBA loan. New business owners might be tempted to procrastinate and quickly fall behind on financial management with this level of freedom. The less pressure there is to repay the loan in a timely fashion, the more time a business owner has to get into financial trouble. A bank/SBA loan may also be taken out for up to 100% (and sometimes more) of the financing needs. This also poses a risk, as the turbulent economy might not allow the business owner to turn around and generate the ideal amount of profit.

BANK/SBA LOAN SUCCESS STORIES

With its benefits and downfalls, there are many examples of how a bank/SBA loan has contributed to the success of aspiring entrepreneurs. Mike and Kim Schmidt from Milwaukee leveraged SBA 7(a) loans to start the first hamburger and shake diner in town, called Bella's Fat Cat. They were eligible for two SBA loans because they started as a small, owner-operated establishment. The first loan for $75,000 covered equipment and leasing costs, while the second for $285,000 was used to purchase an old building for the second location.

Because of its strategic location in a neighborhood where such cuisine is not readily available, the loan to Bella's Fat Cat helped to spark a chain of events and increased profits. Within three years, the couple has opened two more Bella's Fat Cat locations. The restaurants are popular hot spots for locals in the community. Mike and Kim Schmidt continue to enjoy $2 million in revenues annually.

One major bank boasts the following start-up ventures that have been successfully launched with a bank/SBA loan as the sole source of funding:

- Karate School. $620,000 loan to purchase property and refurbish it.
- Tech Consulting Firm. $276, 100 loan to purchase an office condominium.
- Tugboat Operator. $547,000 loan to purchase a tugboat.

These are just a few creative examples of ways that a partnership between an entrepreneur, a bank and the SBA has helped to make small business dreams come true.

WORKSHEET: ASSESS YOUR POTENTIAL FOR SUCCESS

A bank/SBA loan might be the right option for you if your business meets certain criteria. Use the following tool to assess your potential for success with a bank/SBA loan to finance your small business:

1. I have a well-developed business plan.
   ❑ Yes ❑ No

2. I do not have a lengthy credit history or a credit score that is particularly high.
   ❑ Yes ❑ No

3. I have explored other business financing options with little to no success.
   ❑ Yes ❑ No

4. My business is organized as a sole proprietorship, corporation or partnership.
   ❑ Yes ❑ No

5. My business will be independently owned and operated.
   ❑ Yes ❑ No

Add the total number of "yes" responses to the previous questions and use the following guide to determine your potential with a bank/SBA loan:

0 to 1. Your business has potential to secure other types of financing.

2 to 3. Your business may qualify for a bank/SBA loan, however, you need to continue exploring other options as well.

3 or More. Your business may qualify for a bank/SBA loan and this is perhaps one of the only viable financing options available to you.

6

CHAPTER 6: ANGEL INVESTORS AND VENTURE CAPITALISTS

Some of the most renowned and profitable companies in the world, ranging from Compaq, Amazon and eBay, have achieved their success through the help of private equity investors, such as angel investors or venture capitalists. The biggest and most lucrative start-up financing option is addressed here to leave you with a forward-thinking approach to the future and your small business.

Angel investors and venture capitalists were discussed briefly in chapter three as part of the 4th tier of business credit. These investors are individuals or groups that are looking to invest their money in lucrative business opportunities.

Qualifying for start-up funding from private equity investors can be highly competitive. In fact, only 2% - 5% of entrepreneurs who pitch ideas to private equity investors ever receive funding. It takes a very special combination of competitive edge, industry experience, creativity and innovation to attract the interest of an angel or venture capitalist.

ANGEL INVESTORS

Angel investors are ideal for startups that need less than $3 million in funding.

An angel investor is basically an affluent individual who is willing to put up the capital for a start-up business to get off their feet. There are angel investment groups around the country that pool together individual angel's monies to invest into different startup endeavors.

The capital for the business is funded in exchange for another "asset," such as equity in the business or debt with a repayment plan. Angel investors will need to clearly see that you have a viable exit strategy. For angel investors that hold equity shares, a common exit strategy will be to sell shares to the principals. Angel investors that hold debt will want to see viability in selling or merging the company with a larger entity.

Generally speaking, angel investors are ideal for startups that need less than $3 million in funding. Companies that need more than $3 million should pitch to venture capitalists.

As angel investors fund startup organizations with unproven track records, the risks associated with this type of financing are dramatic. Subsequently, an angel will expect a handsome return on investment. Most of them only seek out opportunities that feature a potential return of 10 times or more on their money.

VENTURE CAPITALISTS

Most venture capital firms specialize in a particular industry, and they provide funding ranging from $5 million to $20 million.

Venture capital is a type of private equity funding that stems from both institutional and individual contributions. Organizations and individuals pool their resources into a venture capital firm, who will manage and invest the funds into startup ideas. Some of the most popular industries for venture capital investment include high tech, software, engineering, and medical technology.

While the Silicon Valley is famous for its density of venture capitalists, such as Kleiner, Perkins, Caufield, and Byers, there are VC firms around the country. Most venture capital firms specialize in a particular industry, and they provide funding ranging from $5 million to $20 million. Venture capitalists are looking for high-growth investments in traditionally high-barrier entry industries that will generate significant returns in exchange for their risks.

PROS AND CONS OF PRIVATE EQUITY

Equity funding can fuel the growth of your company—without the burden of regular loan repayments that stifle your cash flow.

Equity funding, whether in the form of venture capital or angel investments, can provide a startup with critical investments to grow. Whether you want to increase your production or capabilities or expand your marketing reach, equity funding can fuel the growth of your company – without the burden of regular loan repayments that stifle your cash flow.

In addition, venture capital firms and angel investors can provide a new company with industry experience, knowledge, and contacts. The investors can help guide important business strategies, including market research, advertising, R&D, and the ultimate IPO.

For this convenience, however, comes an array of drawbacks. Given the high risk that private equity investors must bear, they demand much in return, including:

Ownership. Venture capitalists will negotiate their funding for a significant ownership share of the company. Although you may be comfortable giving up 40% of your company to a venture capital firm in the early stages of your startup, how much value have you relinquished when the company reaches its growth potential?

Control. Although the micromanagement of your company will remain in your and your management team's hands, venture capital investors will have a degree of control in the company. They will sit on your board of directors and influence major decisions that need to be made for the business. Angel investors are notorious for taking a very hands-on approach to their business interests.

Exit Plan. Considering that private equity investors make their profits at the point of exit, you must have a definable exit strategy, usually accompanied by a timeline. In many cases, especially if the company is bought out or merged with another competitor, you will need to exit at the same time as the venture capitalists.

SUCCESS STORY: PRIVATE EQUITY FINANCING

There are many tales of success that stem from angel and venture capital endeavors. Both Polaroid and Apple were started with venture capital funds. Angel investors contributed to the development of Google, PayPal and LinkedIn. Even social networking giant Twitter has reaped the rewards from venture capital as a financing resource.

It is important to remember, however, that many of these companies had a track record (albeit a short one) with significant potential before an angel investment or venture capital relationship came to fruition.

It takes time and energy to develop a relationship with a venture capitalist or angel investor. The key to success in these types of business financing endeavors is strategic planning, pitching to investors that specialize in your industry, developing a product or idea that just can't be overlooked, and making contacts with the right people at the right time.

WORKSHEET: ASSESS YOUR POTENTIAL FOR SUCCESS

Angel investors and venture capitalists are incredibly selective; therefore, you should evaluate your business situation before pursuing one of them as a funding source. Use the following tool to assess your potential for success with angel investors or venture capitalists:

1. I have a rock-solid business plan, complete with detailed financials and projections. The projections indicate very impressive, high-growth earnings in the future.
   ❑ Yes ❑ No

2. My industry is directly related to science, technology, engineering, or another field that has a high barrier to entry.
   ❑ Yes ❑ No

3. I have the time and resources to develop presentations for potential investors and spend time building relationships.
   ❑ Yes ❑ No

4. My idea is unlike any other that I have seen in recent years.
   ❑ Yes ❑ No

5. I am prepared to face fierce competition and due diligence in order to sell my idea.
   ❑ Yes ❑ No

   I am comfortable relinquishing a percentage of my ownership and control in exchange for funding.
   ❑ Yes ❑ No

Add the total number of "yes" responses to the previous questions and use the following guide to determine your potential with business lines of credit:

0 to 1. Angel investors and venture capitalists are not for you.

2 to 3. Angel investors and venture capitalists are not for you. Spend more time on your business plan and hone in on a more specific market.

3 or More. You are in a position to explore relationships with angel investors and venture capitalists. Begin developing a solid presentation and research viable relationships diligently.

7

CHAPTER 7: WHICH OPTION IS RIGHT FOR YOU?

When it comes to business financing, **there isn't necessarily one umbrella solution** that will take care of all your funding needs.

Now that you have read about the many different start-up options that are available and explored your potential for success with each one, you may still be asking the question, "Which financing option is best for me?" When it comes to business financing, there isn't necessarily one umbrella solution that will take care of all your funding needs.

Using the results of your worksheets from chapters 1-6, you should have a good idea of which types of financing options are viable for your business. Most likely, you will have identified two or more financing options that are suitable or reasonable for further consideration.

Create a chart that highlights the pros and cons associated with each financing option. Then rank each advantage and drawback based upon its importance to you. This will help you compare your options across the board with your specific priorities in mind.

You should also review your list of viable options with the following points in mind:

- Many business owners, especially those involved with start-ups, have to use more than one financing option to become fully operational.
- You can get started on some operational endeavors (i.e. business development, marketing, tweaking business plans, etc.) without the full amount of money to open the doors of the business in hand.
- Sometimes it takes a loss to make a profit.

These guiding principles should help you take an objective and honest approach to your business financing endeavors. There is no one simple solution for the business financing search or the processes associated with obtaining funding. It takes an investment of time, energy and self to create the right financing scheme for your business.

Don't make hasty decisions when it comes to choosing financing for your start-up venture. Every single strategy has its own associated advantages and drawbacks. Thankfully, with the knowledge and skills you have gained from this eBook, you are armed with the right tools to make a smart decision about financing your business venture.

ABOUT MOREBUSINESS.COM

MoreBusiness.com is an award-winning small business website filled with sample business plans, marketing plans, templates, sample contracts and business agreements to help entrepreneurs start and grow a small business. MoreBusiness.com is part of a series of sites run by Khera Communications Inc., which includes email marketing service, MailerMailer, and discussion group management tool, DiscussThis.

How to reach us:

Fill out this contact form www.morebusiness.com/contact