

FUNDING YOUR SMALL BUSINESS GROWTH



Six Sources of Capital



Beware Bogus Lenders!



Your Business Plan



Resource Listing

Tapping Your Assets



Language of Finance



Elements of Your Business Plans



Every entrepreneur knows that it takes money to startup or grow. Finding the right funding source, however, is another matter. Do you go to the bank of "mom and pop" or talk to "angels?" Or is a venture capital firm your best route to leveraging your success?

This guide presents a basic overview of the funding process, including an overview of six sources of capital, financial terms, and basic requirements for a business plan.

As you assess your options, remember that a great deal of your funding success depends upon what you are willing to pay or give up and what investors or lenders will receive as a return on their investment.

Be open-minded, but don't forget that your hard efforts brought you to this point!

SIX SOURCES OF CAPITAL

The six basic sources for start-up funds or expansion capital consist of:

Personal Savings:

Know how much you are willing to invest and be cautious about personally guaranteeing obligations and/or pledging your personal property as collateral. If you turn to the bank of "mom and pop" - or any family member or friend - always draw up a formal agreement, and view these individuals just like business associates. When it comes to borrowing money - no matter from whom - it's best to have everything in writing.



Private Investors or Angels:

The power of your business network may be greater than you ever imagined! Private investors often represent the easiest and most cost-effective capital resource. Your network of accountants, lawyers, doctors and other professionals may lead you to those who seek investments with higher returns - and investments that are, perhaps, less speculative than the stock market.

Private investors, commonly referred to as "angels", often appear through prior business contacts or those familiar with your company's products or services. Most angels are interested in your company's market potential, the experience of your management team, and the uniqueness of your idea.

Even customers have opened their checkbooks for promising investment opportunities.



Example:

After opening a successful cafe in Atlanta, the owners had depleted their initial savings of \$55,000, but their 35-seat cafe was raking in \$272,000 in revenue. Still, the owners were faced with delaying an expansion without additional capital. When a customer encouraged the owners to expand in order to capitalize on the 1996 Summer Olympics, she also put her money where her mouth was by writing a check for \$25,000. The new funding allowed the owners to add 50 new seats and redecorate in time for Atlanta's big event.

Payback for the customer?

A 1% royalty of gross sales monthly with guaranteed monthly interest payment of not less than 10% on the principal. At the end of five years, the customer / investor receives a balloon payment. Not a bad deal for either party because both capitalized on a business opportunity.

Venture Capital Firms:

These firms usually want equity or part ownership of your business in exchange for money. Initially, most venture firms do not want more than a 30 to 40% interest in a company because they want the owner to have an incentive to keep growing the business aggressively.

Most venture capital firms are interested in investments requiring \$250,000 to \$1.5 million in funding. In fact venture capitalists are not players if there isn't much profit potential, and they should not be used if you're looking for small loans (under \$250,000).

Be prepared with a formal presentation and to negotiate the deal.

For every 1,000 proposals received by a venture capital firm, 90% will be rejected because they do not fit the selection criteria established by the firm or because the proposals have been poorly prepared. The remaining 10% are investigated carefully. As a rule, venture capitalists seek three to five times their investment in five or seven years.

Typically, venture capital firms provide capital in exchange for stock. Venture leasing is also an option where the lessor takes warrants or some other equity investment in exchange for equipment, facilities, or other assets. The result is a mixed investment vehicle similar to a debt-with-warrants investment. Deals range up to \$2 to \$3 million with this financing arrangement.

Chief Criteria for Making Investment Decisions:

- ✚ Track record of your company's key people.
- ✚ Commitment of your key people to selling your product or services.
- ✚ Distinctive strategic element that characterizes your company.
- ✚ Core technology or innovative practices, rather than a single product focus.
- ✚ Strong intellectual property protection.
- ✚ Type and size of your targeted markets.
- ✚ Amount of money needed to bring your company to break-even.



Banks and Credit Unions

Banks have been the chief providers of loans in the past, but now invest in areas with less risk and government regulations than small business. In general, bank's loans are possible for companies with established records of solid revenues and profits and with sufficient assets to secure the loan.

Also, banks can't be hurried, and, typically, have procedures for the loan approval process that may require a good deal of time. Like other businesses, banks are influenced by a number of factors in making their loans, including state and federal regulations, accounting and marketing considerations, and the general financial state of the bank's portfolio.



Nevertheless, you should establish and maintain a good relationship with a local bank. In developing a banking relationship, Jeff Pfeffer, a senior vice president in the banking industry, suggests targeting a banker who knows about your industry. "One great way to find a banker is to look around the room when you go to a trade function. Odds are, you'll see some bankers. They're the ones who want to concentrate on your industry," says Pfeffer. Source: Inc. Magazine, January 1997 Issue.

In analyzing a loan applicant, banks look at four key areas:

- ✦ Character
- ✦ Capacity to repay
- ✦ Collateral
- ✦ Purpose

In addition, small business friendly banks have been identified and ranked by the SBA in terms of their performance. Both certified and preferred lenders for small businesses can be found at the SBA's web site: sba.gov

Credit unions are similar to banks, but you must be a member of the credit union to get a loan. All loans are personal loans; therefore, you would be personally liable for the loan to your business. Interest rates may be lower than market rates; however, credit unions will want considerable collateral.

Commercial Lenders:

Lending money is big business, and there are hundreds of firms that loan money to small businesses. These lenders usually have more money available to loan; however, they generally want higher interest rates and shorter payback terms than banks. Check the internet for commercial lenders in your area,



Federal, state, local government agencies:

Rarely do governmental agencies loan or grant money to small businesses. Governmental agencies do issue guarantees to private lending institutions to partially support loans. The SBA has several programs contact them for information. The best way is to visit the Small Business Administration's website www.sba.gov. Not only does the site provide a wealth of capital ideas, the site includes information about loan programs and lender programs, as well as loan forms. Current press releases affecting small businesses are also posted, as well as updates on workshops, loan statistics, and assets for sale.



TAPPING YOUR ASSETS

Before you obtain a loan or sell part of your equity or ownership in your business, review your company's assets to see if you can raise the money from your business. Look at which assets can be converted to cash.

Here are some of the most common areas:

Accounts receivable factoring:

You can sell your receivables to factors (i.e., companies that are in the business of buying receivables) to get money relatively quickly.

Inventory Loans:

Any inventory products that are unencumbered (are paid for) and you think will be sold in the near future can be used as collateral for a loan. A bank or commercial lender may give you a loan on the value of the inventory.

Advance sale of goods:

Offer discounts to customers to prepay for your products or services. Sell gift certificates. Get periodic work-in-progress payments from customers contracting to buy goods or services.

Use trade credit:

Stretch out payment terms for goods / services you buy. Ask trade vendors for discounts for early payments or cash up front payments. Negotiate all terms and / or barter if appropriate. Ask those whom you owe money if they would accept a deferred payment schedule.

Once you've considered the major components of successfully raising money for your business, your next step is to keep doing your homework. Look for additional resources that may be available to you. For example, in recent years, home equity loans have become a popular source of capital. If available a home equity loan may allow you to borrow as much as 80% of your home's appraised value. The interest on the the loan may be tax-deductible; ask your accountant.



However, before you approach anyone about loaning or investing money in your business you should:

- 👍 Know what kind of money you want – debt or equity.
- 👍 Prepare financial statements and data that answer these questions
 - How much money?
 - How many years does your company need the money?
 - How much will you pay for the money?
 - How does your business need to perform in order for a lender or investor to get a return on their investment?
- 👍 Understand fully the terms of the loan or equity and how it affects you personally.
- 👍 Engage an accountant or consultant, if necessary, to assist in developing your business plan.

Raising capital for your company is a serious proposition. Be sure you're ready for it and prepared to understand the consequences of borrowing money from both personal and professional resources. Targeting your capital resources and preparing a solid, thorough business plan are the two key steps to your funding success!

BEWARE BOGUS LENDERS:

Capital hungry small companies have been the target for con artists for years. Watch out for these "red flags" when you're seeking the services of a money broker.

Red Flag #1 -Guaranteed loans, credit, or venture capital investments:

When it comes to lending capital, any words that suggest guarantees are a sure sign of trouble ahead.

Red Flag #2 - Upfront fees:

Avoid deals that require these fees. The safest course is to negotiate fee structures tied to the amount of funds that are actually raised.

Red Flag #3 - Internet pitches:

This is a growing scam now that Internet usage is thriving. Con artists on the Net don't have to worry about charges of mail fraud if they're caught.

Red Flag #4 - Nigerian-letter scams:

Watch out for overseas pitches that offer money through the mail. Nigeria is frequently one of these locations. Con artists are adept at requesting bank account information that lets them loot you electronically or demand large up-front payments to cover expenses, once you've given them the information they seek.

If you think you've been scammed, call the Federal Trade Commission at 202-326-2222, your local branch of the U.S. Postal Service if a solicitation through the U.S. mail was involved, or your state attorney general's office.



LANGUAGE OF FINANCE:

Financial Statements:

Used as a reference for Profit & Loss Statement (which shows revenues and expenses and your income or loss) and the Balance Sheet (which reflects your assets, liabilities, and owner's equity). Additional financial reports such as Cash Flow, Break Even Analysis, Sources and Uses of Working Capital, and Financial Ratios Analysis are also often included.

Debt or Equity Capital:

Describes what kind of capital you are seeking. Debt is usually in the form of a loan, promissory note, mortgage, or other legal instrument. Equity is an ownership position in the business.

Rate of Return (Yield):

The primary purpose of investing your money or getting other people's money is to earn a return on capital. This number indicates what profit or interest investors, or lenders receive for investing. Prior to approaching any source for funds, you should know what kind of yields they are seeking.

Cash Flow:

This is the life blood of a company. Cash flow is the generation of funds available to pay expenses and returns to investors or lenders. Cash flow reflects the timing and amount of inflow and outflow of funds.

Working Capital:

Typically, this figure represents total assets that will be converted to cash within a year minus liabilities that must be paid within a year.

Collateral:

This is property accepted as a secondary source of repayment of a loan or other obligation.



Break Even Analysis:

A method of assessing a company's profit potential downside risk. Expenses should be separated into variable costs (labor, materials, and commission.). With these costs and estimated revenues per unit you can determine how much product / service must be sold to cover costs. At breakeven your company incurs neither a profit nor loss. The breakeven analysis is an important tool to illustrate the effects of product price changes, cost increases or a reduction in demand on the company's profit or loss.

Margin:

The difference between revenues received and expenses incurred and commonly expressed as a percentage or dollar amount. Gross margin is the difference between total sales revenue and total cost of goods sold. Net margin is the difference between total sales revenue and all costs associated with producing goods, including administration, taxes, and other overhead expenses.

Leverage:

The ability to borrow a larger amount of money than a company has invested in property or assets.



YOUR BUSINESS PLAN:

To run a successful business, you have to have a PLAN. Without a well written and documented business plan you will not only be unable to raise capital, your business will not perform well. You have probably heard that most businesses fail because they lack sufficient funding. This is typically because management has failed to PLAN to have enough money at the right time for the right reasons.

Having a business plan helps you:

- 👍 Raise capital
- 👍 Plan contingencies, reduce risk, and avoid errors
- 👍 Enhance your knowledge and improve your business' performance
- 👍 Facilitate decision-making situations
- 👍 Establish operating standards to use in tracking and budgeting
- 👍 Support the launch of new products, services, or ventures

You have two options in developing your business plan:

- 👍 Prepare it yourself
- 👍 Hire a professional deal packager

Your business plan is a make it or break it proposition when you approach a lender or venture capital partner. Be sure to prepare a well-organized, clean and attractive document. You should have a cover to this plan and bind it for a professional "finished look." Remember, there are thousands of businesses competing for limited capital resources every day.

Make your plan a standout through its attention getting, clear and easy-to-read format.

The following are the key components of a solid business plan:

Figure 1

This should be a brief (2-3 page) summary of the detailed business plan. Describe the essence of your business, explain to investors what makes your business worthy of an investment in it, and other basic information.

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These topics should be detailed and complete. If there are employees discuss key employees and their functions, as well as company policies and procedures.

Figure 1

This section should address questions that prospective investors may have on the structure of the deal. Describe the return on investment. Debt investors will look to cash flow and collateral to cover principal and interest payments. Equity investors generally seek appreciation and look for increased future earnings for a return.

Figure 1

Define your market and describe your marketing strategies. Identify your market competition and discuss how your company is positioned relative to your competition. Include any market surveys, test market results, trade association reports and government statistical data as exhibits.

Customers and Suppliers:

Describe your current customers and potential customers. Quantify as much information as possible, such as how many, for how long, how much each customer's account represents of your total business, etc. The same type of information should be provided for the major suppliers you use in your business. Detail any contracts in place, advance payments, credit terms, and working relationship.

Production and Operations:

Describe how you produce your products or services and discuss quality control, capacity, facilities, technology and safety. Provide a production flow chart which shows the process(es) from beginning to end with timeframes included.

Government Regulations and Legal Matters:

List all licenses, permits and approvals necessary to conduct your business. Discuss local, state, and federal regulations that affect your company and which agencies you will interface with on a regular basis. Also, provide information about how potential or proposed changes in the law could affect your company. Legal matters should include any litigation that your company is currently involved in or, if applicable, potential litigation.

Historical and Pro Forma Financial Data:

Provide historical financial statements as well as projected or pro forma financial information. Include narrative to explain major variances, assumptions used in doing projections for pro forma, and general accounting methods.

Strategic Planning:

This section explains how and why your company will grow and prosper over the next three to five years. You plan to reduce your risks; how changes in the general U.S. economy will affect you, both positive and negative; and how you are going to continue to build your business.



RESOURCE LISTING:

The SBA works with a number of local partners to counsel, mentor, and train small business.
<https://www.sba.gov/local-assistance>

Loans:

Start or expand your business with loans guaranteed by the Small Business Administration. Use Lender Match to find lenders that offer loans for your business.
<https://www.sba.gov/funding-programs/loans>

Investment capital:

Find an investor for your business through a Small Business Investment Company (SBIC) licensed by the Small Business Administration (SBA).
<https://www.sba.gov/funding-programs/investment-capital>

SBDC - A network of centers that provide counseling and training to help small business owners start, grow and expand their business. <https://americassbdc.org/>

SCORE - Volunteer business counselors, advisors, and mentors who offer individual free to low-cost counseling throughout the U.S. and its territories. <https://www.score.org/>

Veterans Business Outreach Centers - Designed to provide entrepreneurial development services and referrals for eligible veterans owning or considering starting a small business. <https://www.sba.gov/page/veterans-business-outreach-center-vboc-program>

Women's Business Center - WBCs provide free to low-cost counseling and training and focus on women who want to start, grow and expand their small business. <https://www.awbc.org/>