

15 SOURCES OF FINANCING

1. **Personal Savings.** A lender or investor will expect that you are investing a significant share of your own assets before trusting you with theirs. About 30% to 35% of the loan amount is typical. It is rare to be able to start a business with zero capital.
2. **Friends and Family.** The people who know you best will likely be your most willing backers. You would be smart to formalize a loan or investment with proper documentation to satisfy the IRS – an interest-bearing, promissory note in the case of a loan, or shares in the company in the case of an investment.
3. **Grants.** Usually not available except to non-profits. But check out “Grant Resources for Small Businesses” at http://www.score.org/fc_17.html to see what specialized possibilities might exist.
4. **Home Equity.** If you have equity in your home, you can probably use it to obtain a loan. But the bank may want to take a second mortgage on your home as collateral. If the home is held in joint tenancy, you will need the approval of your spouse.
5. **Credit Cards.** Best used for convenience, not long term financing, because interest rates are so high on unpaid balances.
6. **Venture Capital and Angel Investors.** These sophisticated investors look for second-stage enterprises to back, hoping to cash out by taking them public in a few years. They seldom back start-ups, and typically require control.
7. **Banks and Credit Unions.** Small business lending is the bread and butter of commercial banks and other lending institutions, but they are not an easy sell. They seldom back start-ups or certain high-risk ventures, such as new restaurants. They typically require a well-thought-out business plan and expect to secure a loan with adequate collateral. Even with collateral, a bank will want you to sign personally. And they may require a credit-worthy co-signer – another possible role for friends and family.

Consider whether you need a term loan, which may give you several years to pay it off, or an annual line of credit, which charges interest only on the amount of the loan in use at any given time. A cash management account automatically sweeps excess balances from a checking account into a money market fund, or conversely, draws down on your line of credit when your checking account balance falls below a certain level.

In banking, relationships are very important. Get to know a business banker, and start providing quarterly financial statements in advance of needing a loan. The more of a bank’s products you use (credit card, car loan, home mortgage, checking account, savings account, trust account, investment account), the more important you become.

- 8. SBA Financing.** The U.S. Small Business Administration neither gives grants nor makes loans. Rather, it guarantees a portion of marginal loans that participating banks would like to make, but can't quite justify in terms of the risk. Often, lack of sufficient collateral is the trigger. Thus, an SBA-backed loan is more costly than a straight bank loan, since it involves a guaranty fee and a slightly higher interest rate.

A borrower does not apply directly to the SBA for financing. Instead, the borrower's bank chooses whether or not to use one of the SBA's many specialized programs, based on size of the loan, type of borrower (minority, woman, veteran, etc.), and intended use of the money (working capital, technology, agriculture, real estate, etc.).

- 9. State and Local Programs.** The Illinois Department of Commerce and Economic Opportunity, as well as various local development corporations, enterprise zones and communities have programs to encourage lending for a wide variety of purposes. Explore Illinois possibilities at http://www.commerce.state.il.us/dceo/Bureaus/Business_Development/Loan+Programs/
- 10. Micro Loans.** If your needs are modest and your credit poor, a micro loan could be the answer, though you will pay a higher interest rate than you would through a conventional bank. Some micro lenders are backed by the SBA.
- 11. Online Lending.** Peer-to-peer lending over the Internet is available for both consumer and business purposes. Amounts are usually small, and rates vary according to how bidders perceive your risk. Search on Online Lending to locate the current players in this evolving market.
- 12. Leasing.** A sensible way to buy expensive equipment may be to lease it, especially if it is subject to technological obsolescence. Like real estate, capital equipment can sometimes serve as its own collateral.
- 13. Vendor Financing.** When you purchase inventory on Net 30 terms, the vendor has given you a 30-day, interest-free loan. When you fail to pay promptly, you risk the relationship. But if you are going through a rough patch, you may be able to negotiate 60- or 90-day terms on an amicable basis. The key to such vendor financing is honest communication.
- 14. Factoring Accounts Receivable.** There are companies that will "buy" your accounts receivable for a high percentage of their face value, giving you cash today that might otherwise take months to collect.
- 15. Bootstrap Financing.** When using other people's money is not an option, you have no choice but to grow your business organically – that is, use your operating profits to grow at a slower rate than outside financing would permit. It's amazing how many businesses have followed this prudent model to long term success.