



FINANCING FUNDAMENTALS

What Does Your Business Need? - Equity, Debt or Alternative Financing

Too often women business owners look for financing in the wrong place. They think that since they are a start-up business they need 'venture capital' or a Small Business Administration (SBA) term loan will help when they face a crunch for working capital. The following paragraphs will provide some guidance to helping you identify the type of financing you need for your business.

Equity

When an individual or an institution 'invests' in your company, they are making a capital contribution to your business. In return, they own and have control over some portion of the business and will get repaid through profit sharing or when the company is sold. The business has to have the following characteristics in order to be attractive to investors:

- High profit margins to provide attractive profit-sharing income (dividends) to the investors.
- Product or service must have significant market appeal and show the potential for rapid future expansion.
- Potential for a significant return on investment through an 'exit strategy' such as 'going public' or acquisition by a larger corporation.
- Barriers to entry for other competitors. This can include proprietary technology, patents and/or established market presence.

Stages of Equity Investment:

- 1st Family and friends
- 2nd Angel investors (people who understand your type of business)
- 3rd Early Stage Venture Capital firms
- 4th Later Stage Venture Capital firms

Funding Process: Can be lengthy and expensive.

Debt

Debt financing is when you 'borrow' money from a bank or alternative financial institution. The lender expects to get paid back over a specified period of time. In order to make sure that the lender will be paid back, the lender determines if there is enough cash flow to repay the debt and asks for a lien on additional assets that can be sold to repay the debt if a borrower defaults. A business is considered to be attractive to lenders if it displays the following characteristics:



- Borrower has good personal and business credit history that indicates good 'character'.
- Business financial history indicates there is enough cash flow to repay the loan or,
- There is substantial information provided that shows the potential for the business to generate enough profit to repay the loan.
- The business is not carrying significant debt already (debt/net worth should not be more than 4:1).
- The business and borrower have sufficient collateral to offer as a second source of repayment.

Types:

1. Term loans: Usually for start-up, expansion, purchasing of fixed assets, real estate and other one-time costs that have to be amortized over time. Working capital can often be included in a term loan.
2. Line of Credit: Usually to cover variable/seasonal or working capital needs of the business. Money is borrowed for short periods of time, can be repaid, and then is required again.
3. Special Loan Programs: Government (SBA, state, city) and alternative loan programs (e.g. microloans) offer primarily term loans and some lines of credit. Most loan programs are offered in conjunction with a bank. Special loan programs are used when:
 - There is insufficient collateral
 - There is insufficient owner equity or downpayment
 - Loan is considered 'risky' because of the type of industry, the business is a start-up or emerging business, or there may be a problem in the ability to repay the debt through traditional means.
 - Loan size is small (under \$25,000 are often originated through microloan programs).

Funding Process: Once all documentation has been received and reviewed, many bank loans can be closed within 2-3 weeks. If a special loan program is used the processing time can increase to 6 weeks.

Other Financing Options

Accounts receivable financing, purchase order financing, contract financing, and leasing are other types of financing.



For more information

SBA Loans: www.sba.gov/financing

State Loan Programs: www.illinoisbiz.biz

Microloans: www.accionchiago.org

www.wsep.com

General information on financing: www.onlinewbc.gov