5 Ways to Manage Business Financing

You've come up with a unique idea, and you have a stellar business plan. With your own business you'll have financial security and freedom from your boss. Only one thing is missing – capital. You can't make money without money. So until you raise the funds you need to develop your business dreams into a reality, then you are at a standstill. Using your own cash to raise capital is an easy way to bypass writing proposals and stressing over approval. However, everyone does not have the available resources to finance his or her own business. Don't despair! Here are a few options for effectively financing your new business. There is still hope for the entrepreneur who is strapped for cash. Consider the following options:

1. Equity Financing

Business owners typically carry the entire financial load. For new entrepreneurs, this can be difficult, especially if the business is capital intensive. If you want to disperse your financial burden, you can sell equity or ownership interest in your company to a third party – an investor. In a corporation, equity takes the form of common or preferred stocks. Equity can also be membership units in a limited liability company, or a partnership interest in a partnership arrangement.

What are the Pros and Cons of Equity Financing?

With equity financing the business does not incur debts. It receives a fresh infusion of capital. Businesses incur plenty of start-up costs. Start-up costs are inevitable for new businesses, and if you don't have to borrow to defray these expenses, your business will grow faster. The downside to this financing method is that selling equity will dilute your interest and lessen the control you have over your business. If your reason for going into business was to eliminate your boss, then you should be aware that having an investor creates a new kind of boss. Looking for interested investors can also be time consuming. The ideal catch would be a person or entity with the money for financing and a real belief in your business. It can be difficult to find a steadfast investor in the early stages of business development because you are basically selling an idea. In addition to developing the products or services you hope to sell, finding a solid investor can easily become a second full-time job. Additionally, if you don't find the investor you need in time, then your business can shut down before it really starts.

Determining what is attractive to investors is more of an art than a science, and every potential target will require a different approach. While you may be an expert in the product or service you will offer, you may not have experience looking for investors. However, if you are successful, your business will get the necessary infusion of capital.

2. Bank Loans

An alternative to equity financing is debt financing. Bank loans are the most common type of debt financing. To obtain a bank loan, you need to present a business proposal to your bank of choice. If you already have a strong business relationship with your bank, then the process will be easier for you. The advantage of seeking a bank loan is that it's usually faster than equity

financing. Additionally, your bank is an institution where they are familiar to you, and you are familiar to them. You have a higher chance of getting financing from a familiar banking establishment than by convincing an investor that you do not know. While finding an investor who believes in your business can be challenging, banks are already in the business of lending. Most banks have a brick-and-mortar presence and a built-in process in place for taking out a loan. With this option, you will not have to re-invent the wheel; you will just have to follow procedures. Furthermore, the cost of the money (principal and interest) is readily measurable. You will know how much you have to pay the bank down to the last cent. You will know the costs of not paying on time or not paying at all. The best thing is that your ownership is not diluted. Banks are not owners, but merely creditors, so in theory, they have no say in the business. In contrast, investors have much more control.

What are the disadvantages of bank loans?

Although bank loans are enticing, they have their disadvantages. After all, it is still a debt. Therefore, the loan must be paid whether the business fares well or not. Banks will not care whether you are making a profit. They simply want to be paid in accordance with the agreement. While the bank does not have control of the business, their interests take precedence over those of the investors. So while investors will get what is left after all the debts have been paid, a bank loan must still be paid even if the business fails. At the same, debts are reflected in the company's balance sheet. This can make the business unattractive to investors. Servicing the debt also puts undue strain on the business cash flow because bank loans usually have a set due date. Your bank of choice may have onerous requirements that include submitting to a quarterly audit and issuing the lending institution annual financial statements. These requirements can hinder the flow of business. As you can probably imagine some banks require the completion of a huge stack of documentation before approving a loan. The entire process can consume lots of valuable time that you could be spending running your business. Instead, a large share of your time and energy is devoted to pleasing your creditor.

3. Small Business Administration (SBA) Loan

If your new venture falls under the category of a small business, then you may be able to secure a loan from the Small Business Administration (SBA). This program provides funds specifically for small businesses that cannot otherwise obtain a loan. The maximum loan allowed is $2M, and it is delivered through a commercial bank. The bulk of the principal is guaranteed by the SBA. SBA also offers a 504 loan program that provides financing to small business owners who want to acquire land, buildings, or equipment. This specialized loan cannot be used as working capital or inventory. A microloan is also an [SBA] option to consider. With a Microloan, a small business can get a Microloan loan of up to $35,000 for working capital, inventory, furniture, supplies, etc. Programs are also offered for special groups that include women, minorities, or veterans. The SBA is an agency that operates like a bank, but has a targeted client base.

What are the Pros and Cons of an SBA Loan?

Since the SBA is still providing a loan, the advantages and disadvantages are very similar to those of a bank loan. However, an SBA loan can be considered more advantageous to new businesses because they offer lower rates, and generally better terms. However, there are

misconceptions about SBA programs. Contrary to popular belief, SBA loans are not grants from the government. They are loans that the debtor must repay. Although the terms are substantially better than the terms in a bank loan, the SBA is not a bailout agency. Therefore, it is available to more than just distressed or start-up companies. The SBA can fund healthy businesses that need bridge financing or an extended term loan. Because of misperceptions, business men and women often overlook SBA as a viable resource. At the same time, this resource is not available to everyone, and the amount may not be enough for some types of startups.

4. Financial Brokers

Getting financed can be challenging and time-consuming. Invariably, you will the paths of financial headhunters or brokers when you look for underwriters. A broker is an individual or company that will look for financing for you in exchange for a commission. While this frees up your time to focus on running your business, a broker may also demand a portion of your company's equity as part of their fee.

What are the Pros and Cons of Using a Financial Broker?

The advantage of hiring financial brokers is that you can delegate the work of putting together the financing for your company. Looking for investors is hard work. Brokers take this challenging project off your hands so that you can concentrate on your business. They have experience and expertise in looking for investors, and they usually have a portfolio of ready investors on hand. If you are fortunate you might get an efficient broker who can produce a portfolio of promising financiers, from which you can make a selection. Even if they do not at first have potential investors already lined up, they know how to put together a list in a short time.

On the other hand, unlike stock brokers, attorneys, and accountants, financial brokers are generally not licensed. Therefore, there is little governmental regulation over them. There is also limited public information available about financial brokers. So unless you really know how to dig, you may have a hard time looking for background information about a broker. If there is available information, it may not reflect all there is to know.

However, if you do decide to go with a Financial Broker, it is important to insist that references are presented from past clients. Ask the clients about the work of the broker and if at all possible, do not pay up-front fees. If a broker asks for travel expenses, carefully monitor them and allow a reimbursement only on a case-by-case basis. Avoid signing exclusivity agreements with just one broker. If you have to, insist on a period (e.g. 30 or 60 days only) for the exclusivity. And finally, do not pay any fees until after financing has occurred. There are many cautionary tales on financial brokers, but there are also many stories of success. If you do decide to use a broker, be cautious.

5. Revenue Participation/Royalty Financing

This is a creative form of financing that can become complex at time. This sort of financing is best with close supervision from your legal and accounting team. Revenue participation occurs

when an investor buys into a percentage of a future revenue stream of the company. Therefore, the investment is based on estimated income instead of ownership in the company. A royalty financier receives no stocks or shares. The payment is usually computed in relation to a percentage of the income, and is made over a period of time.

What are the Pros and Cons of Revenue Participation/Royalty Financing?

Revenue Participation/Royalty Financing can be risky on the part of the investor for obvious reasons, but very attractive to the business owners. If there is no revenue, or revenues do not come for a time, then the royalty financier will not make any money. On the other hand, if an investor picks a winning business, then he can make a lot of money. Financier payments usually come before the expenses of the company, and this is regardless of the business' profitability. This option also offers a higher investment rate of return (IRR) with lower risks. The gains are easier to compute. With a review of the revenue stream of the company, investors will know how much has been earned. There are less personal conflicts with this option because management remains with the owner. Additionally, business stocks are reserved, and can increase in value over time. Payback of the investment is as flexible as the incoming revenue of the company, so you would only pay when you are able. Since payment is tied to revenue, an investor is more likely to participate in promoting the company. This basically means that you get bonus marketing without necessarily paying a fixed income!

The downside to Revenue Participation/Royalty Financing is that it is highly speculative. No one really knows whether the product or service will be a hit in the market. It is also undetermined when the revenue will come in. If you want to succeed, you need an exceptional business plan and due diligence.

There are many more ways to raise financing for new businesses. There is no one best way to finance a company because every business is different. There is also no exclusivity to any option. You can use one or a combination of these methods depending on the needs of your business. You may need to be flexible when it comes to financing. At the same, you may also have to re-think your strategy down the road. Nonetheless, whatever type of financing you choose, you should carefully examine all your options before you commit to any of them.

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