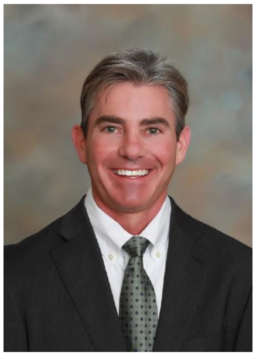

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Raising Capital for Your Business

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Why finance?

An important ingredient to a successful business is adequate financing (capital). The failure to acquire adequate financing often determines whether a business can get off the ground, not to mention whether it can sustain itself after it does. So how much financing do you need and how do you get it? You will require capital for start-up costs (seed money) and, because most businesses incur losses in the beginning months of operation, for your initial operating losses and personal expenses. Be prepared to cover these latter expenses for at least three to six months while the business is given a chance to become self-sustaining. If you are like most entrepreneurs, you may not have the money to cover these expenses.

***Tip:** Before you begin, keep in mind that you may wish to consult an accountant and an attorney, both of whom can be very helpful in your quest for financing. They can be especially useful in assisting you with the preparation of your business plan--the management and financial blueprint of your company.*

How much money do you need?

The first step is determining how much money you need. To do this, you will need to prepare a business plan as well as ask yourself the following preliminary questions:

- Will you be providing a service or a product? At least initially, a product-producing business typically requires more money because it involves high material and equipment costs.
- Will you be hiring employees? Naturally, if you are going to provide most or all of the labor, at least initially, you will require less money than if the business required many employees.
- Will you be investing personal funds? Lenders or investors may require that you invest (and risk) your own money in the business. The amount you will contribute (called "equity") will generally depend on how much you can afford.
- What will your startup costs be? You will need to estimate your startup costs, which you will pay only once. Your startup costs might be estimated by creating a worksheet similar to the following:

Startup Costs	
Remodeling/interior decorating	$_____________
Equipment/machinery	$_____________
Supplies	$_____________
Utility costs	$_____________
Advertising	$_____________
Insurance	$_____________
Professional fees (e.g., lawyer)	$_____________
Business permits	$_____________
Starting inventory	$_____________
Other	$_____________
TOTAL STARTUP COSTS	$_____________

- What will your monthly business expenses be? You must also estimate your monthly business expenses and add them up. When you arrive at a figure for one month, you should multiply it by three. This represents the amount of money you should deposit in a savings account for the initial months of operation. Though oversimplified, following is an example of a monthly expenses worksheet:

MONTHLY EXPENSES

Professional expenses	$____________
Salaries and wages	$____________
Maintenance	$____________
Supplies	$____________
Interest	$____________
Utilities	$____________
Taxes	$____________
Rent	$____________
Advertising	$____________
Insurance	$____________
Other	$____________
TOTAL MONTHLY EXPENSES	$____________
THREE-MONTH TOTAL	$____________

- How much money do you have? After you have calculated your financing needs, determine the amount of cash available. To do so, create a personal financial statement similar to the following:

PERSONAL FINANCIAL STATEMENT			
Assets		**Liabilities**	
Cash on hand	$____________	Debts you owe	$____________
Savings account	$____________	Taxes	$____________
Stocks/bonds	$____________	Other	$____________
Debts owed to you	$____________		$____________
Real estate	$____________		$____________
Automobile	$____________		$____________
Other	$____________		$____________
TOTAL ASSETS	$____________	TOTAL LIABILITIES	$____________
TOTAL ASSETS MINUS TOTAL LIABILITIES = NET WORTH			$____________

- How much of your net worth is available? Now that you know how much you have, you must determine how much is available to invest in your business. A portion of your net worth, such as equity in your home, may not be liquid (easily converted to cash). Further, if you devote all of your net worth to the new venture, you may compromise your family's financial security. Determine what portion of your net worth is accessible and can be invested without subjecting your family to excessive financial risk. This is your available net worth.
- How much do you have to get from debt/equity investors? To calculate how much you have to obtain from debt and equity investors, subtract your available net worth from the sum of your startup costs and three-month expense total:

Debt/Equity Requirements = Startup Costs + (Monthly Expenses x 3) - Available Net Worth

Two ways to capitalize your business

Generally, there are two ways to capitalize your business. You can borrow money (debt) or, if you don't mind sharing ownership, find investors willing to provide the funds you need in exchange for a "piece of the pie" (equity). Debt must be repaid. Equity, however, generally does not; it is simply exchanged for an ownership interest in your business. Which method, or combination thereof, is right for your business depends upon (among other things) how much money you need, your financial situation, the type of business you intend to begin, and how much control over the business you are willing to surrender to others. Before soliciting funds from outside sources, you should consult with your legal advisor to ensure compliance with all federal and state securities laws.

Debt

When you think of debt, you think of loans. Generally, a loan is money temporarily lent to a borrower for some specified use. The money eventually has to be repaid (with interest). You or your business, if it is an independent entity, can borrow funds. If you personally borrow the funds, you become the debtor and are personally liable for repayment. You can then either turn around and invest these funds in your business (equity) or turn around and loan the same funds to the business. If, instead, your business borrows from a third-party lender, your business is the debtor, not you. In practice, however, even if your business is the borrower, a lender may request you to personally guarantee the loan, in which case you would be personally liable for its repayment.

- What should you look for? You should shop around for two things: the right lender and the lowest interest rate. Which lender is right for you depends upon many things, including the lending practices as well as the size, type, and financing needs of your business. Generally, however, you should look for a lender with the following attributes:
    1. Aggressive lending policies
    2. An interest in businesses of your type and size
    3. An interest in serving — and the ability to so serve — your business's various credit and noncredit (e.g., payroll and checking accounts) needs, current and future
    4. Financial stability

The second thing to look for is a low interest rate. The lower the interest rate, the more money you'll have for your business expenses.

- What will debt investors (lenders) look for? A lender primarily looks for two things: your ability to repay and collateral. A lender will let you borrow if he or she believes you are capable of repaying the debt. The lender will make a decision after carefully reviewing the following things:
    1. Your credit history
    2. The risk of failure of your type of business (new businesses are considered riskier than established businesses)
    3. Your personal and business income, both current and projected
    4. Your business/managerial experience
    5. Your equity in the business (the amount you contributed to the business)

Lenders also look for collateral — assets that the lender can keep if you fail to repay your loan. Few people can obtain loans without it. There are many forms of collateral, including, but not limited to, real estate, inventory, equipment, and accounts receivable (what people owe you). Unfortunately, if you have little or no collateral, you will likely encounter much difficulty when seeking a loan.

- What are the advantages and disadvantages of debt? With debt, you do not have to share ownership and control. When you repay the debt in its entirety, the creditor has no interest left in your business. Conversely, loans are difficult to obtain, and once acquired, the loan will saddle you with monthly payments. In addition, you will likely repay an amount much larger than what you borrowed because of the interest charges. If you ever fail to repay, you will be assessed penalty fees, given a bad credit rating, or have the loan "called" (requiring you to pay it immediately in its entirety), which may cause you to lose the business.
- What are the different types of loans? A loan can be an installment loan or a line of credit, secured or unsecured, and short- or long-term:
    1. Installment loan/credit line. An installment loan is money provided in one lump sum that must be repaid in installments (e.g., monthly). A line of credit, on the other hand, permits the borrowing of funds as they are needed; the funds usually have to be repaid within the year.
    2. Short-/long-term. A loan is considered long-term if its term is longer than one year. Conversely, a short-term loan must typically be repaid within a year.
    3. Secured/unsecured. A loan is secured when the lender is given an alternate form of payment in case of default (you fail to pay). When a loan is secured, the lender is given a security — an alternate form of payment (e.g., a mortgage on a

home). The asset that constitutes the alternate form of payment (the home, for example) is called "collateral."

Equity

Equity is all the non-borrowed funds contributed to your business. In other words, all the money invested in your business that you do not have to pay back is equity. You, your friends or family, or strangers interested in a new opportunity can contribute such funds. These funds are exchanged for an ownership interest in the business.

- What should you look for? Generally, you should look for investors who are experienced with, or at least understanding of, your type of business. In addition, unless you're crowdfunding your equity issue, you may want to seek out investors with whom you are compatible.
- What will equity investors look for? An equity investor is giving you money in exchange for the right to share in the ownership and future profits (and losses) of the business. Essentially, you are selling a piece of your business. As such, an investor will expect that the business has the potential to be successful and profitable.
- What are the advantages and disadvantages of equity? Unlike debt, equity investments do not have to be repaid. Because equity investors are eager to make a profit, they might be more willing to take risks than debt investors, who worry about getting their money back. On the other hand, your equity investor may require you to surrender some control over the use of his or her money. This means that you may have to consider the opinions of others as to how the business should be run, regardless of how disagreeable they may be. Finally, equity financing can be relatively complicated. Paperwork needs to be prepared and filed, and various regulations adhered to (e.g., laws regulating the sale of stock and other securities). Equity crowdfunding — that is, selling equity via Internet-based funding portals— is somewhat less complicated than traditional stock issuance.

Primary financing sources

There are many sources of financing available to you. You should consider each carefully before making any decisions. The following list of financing sources should give you some ideas. The list is separated into three parts: debt sources, equity sources, and other sources. (For more information on these and other funding sources, contact your lawyer, visit your local Small Business Administration (SBA) office, call the SBA Answer Desk at (800) 827-5722, or visit the SBA's website at www.sba.gov .)

Debt sources

A. Yourself. You can establish a debtor/creditor relationship with your business. You are the creditor (the lender) and the business is the debtor (the borrower). You may have several sources of funds to tap into and lend the business. You may be able to borrow against a retirement fund, life insurance policy, credit card, or home. You can also liquidate your retirement plan (although taxes and penalties may apply). Keep in mind that this money may have to be paid back to the source from which you borrowed. In addition, to be treated as debt on the books of the business, loans made by you to the business must be repaid.

1. Retirement fund. If you or your spouse are still employed outside the business, you might be able to borrow against either of your retirement plans. You must contact the retirement plan administrator to see if you can do so. If you can take a loan, keep in mind that the extent of your borrowing will be limited by the amount of money invested in the plan. Also note that although interest payments on borrowed funds go back into the plan, they are subject to a double tax: You are paying the interest with after-tax dollars, and when you ultimately withdraw these funds, you will be taxed again. In addition, if you cannot repay the loan in the required time frame, it will likely be treated as a distribution. In that case, income taxes and a possible 10% penalty tax may apply to the outstanding amount of the loan.
2. Life insurance. If you have an accumulated cash value in your life insurance policy, you can probably borrow against it. Moreover, the older the policy, the more likely it will carry a lower interest rate than other types of loans. Your insurer will explain the amount you can borrow, if any.
3. Credit card. If you have good credit, you could probably borrow a lot of money using credit cards. Though credit cards are a source of quick cash, you will likely pay an inordinate amount of interest on the borrowed funds. Heavy credit card borrowing is therefore unwise and should be used only in financial emergencies.
4. Home equity financing. You can borrow against the equity in your home by requesting a home equity loan or line of credit. The downside of this type of borrowing is that you risk losing your home in the event of default.
5. Liquidate retirement plan. You can cash in your individual retirement account, but this can be very expensive. The withdrawal will be included as taxable income (except to the extent attributable to nondeductible contributions), and you may be assessed a 10% penalty for early withdrawal if you are younger than 59½ years old. However, a qualified distribution from a Roth IRA is not taxable.

B. Friends and family. The advantage of borrowing from friends and family is that you can usually negotiate terms more favorable than with strangers. The disadvantage, however, is the potential strain on the relationship. Friends and family can be easily alienated if their expectations go unmet or if they do not get their money back, especially if they were barely able to provide the funds in the first place. You should therefore keep the relationship formal to avoid any misunderstandings, and you should choose carefully the relatives or friends from whom you borrow.

C. Banks. Like most lenders, banks are conservative when it comes to lending money. The bank will not risk its depositors' money unless the bank is reasonably certain that it will get repaid. For that reason, banks are disinclined to lend to new businesses with little or no collateral. If and when the bank lends to a new business, it usually requires a large equity investment by the business owners (anywhere from 25% to 50%), depending on the business. Therefore, a bank may not be a good idea for a long-term, unsecured loan for a new business.

D. SBA. The SBA is a federal program that provides technical assistance (in the form of management counseling and informative seminars), and financial assistance (direct loans, loan guarantees, and tax relief). Though the SBA offers direct loans in specific circumstances, the SBA primarily acts as a guarantor of long-term loans for qualified business owners. The primary lender is a traditional financial institution. In this capacity, the SBA usually guarantees 70% to 90% of a loan, typically for those in business for more than one year. For more information on these and other loan programs, contact your local SBA office, call the SBA Answer Desk at (800) 827-5722, or visit the SBA's website at www.sba.gov .

E. Small Business Investment Companies (SBICs). SBICs are privately owned organizations licensed by the SBA. Like the SBA, SBICs provide entrepreneurs with technical or financial assistance (loans or stock purchases). Similarly, "specialized" SBICs offer assistance to those entrepreneurs considered socially or economically disadvantaged. Funds are limited, however, and both types of SBICs are, like other investors, selective in the type of businesses in which they invest. For more information, contact your local SBA office or the Small Business Investor Alliance at (202) 628-5055.

F. Economic Development Administration (EDA). This federal agency, an extension of the U.S. Department of Commerce, provides assistance to economically disadvantaged areas of the country. The EDA typically provides financial assistance to businesses that locate within such areas. For more information, call the EDA at (202) 482-2900, or visit the Administration's web site at www.eda.gov.

G. Credit Unions. A credit union is a type of financial institution created by a particular group to provide financial assistance to its members. Many companies or labor unions, for example, have credit unions that offer low-interest loans to their employees. If you are still employed outside your business, inquire at the human resources department at work or visit your local library and ask the librarian for a directory of credit unions in the United States. (Note that you typically have to be a member of a credit union to borrow funds.)

Equity sources

A. Your savings. The money that you contribute to your new business will likely represent your equity in the business. For example, if you contribute $5,000, you will have a $5,000 ownership interest in your business.

B. Friends and family. The advantage of obtaining equity investments from family and friends is that you can usually do so without giving up too much control. Conversely, it is quite possible that a friend or relative may, because of the relationship, feel more comfortable about imposing his or her opinions as to how the business should be run. You should therefore keep the relationship formal to avoid any misunderstandings, and you should choose carefully the relatives or friends from whom you solicit funds.

C. SBICs. See description above.

D. Angel. An "angel" is usually an individual with lots of money who invests in startup businesses. Because angels typically engage in such investments regularly, they may be a good source of business expertise. Again, however, the problem with equity investors is the extent to which they will demand ownership and control. Assuming the angel has sufficient funds for your type of business, he or she may require a large share of ownership. Indeed, you may even be required to surrender control and instead be content with a smaller voice in your own company.

E. Venture capital. Venture capital firms are a good idea for two reasons. First, you get money that does not have to be repaid. Second, because the invested funds are equity, banks may be more inclined to extend credit to your business. However, venture capital firms may be a bad idea for other reasons, primarily because they may demand control over your business. In addition, because venture capital is a risky business, firms try to reduce risk by limiting the types of businesses in which they invest to those with the most potential for profitability. Consequently, many venture capitalists may be uninterested in new businesses and the risks they present, unless, of course, the potential for significant profit can be identified and measured.

F. Investment clubs. In many areas, business people get together to form investment clubs. By pooling their funds, they can make larger equity investments (though, of course, as with other equity investors, you will be required to share some control over your business). For more information, contact the National Association of Investors Corporation at (877) 275-6242, or visit the web site at www.betterinvesting.org.

G. Going public. You can also issue stock-ownership interests in the business that are sold by the share. The money or assets contributed in exchange for shares of stock represent shareholder equity in the business. Going public can be complex and very expensive, and it is subject to securities regulations at the federal and state levels. As a result, public offerings are not usually conducted by small businesses or start-ups.

H. Equity crowdfunding. An alternative to the traditional method of going public is equity crowdfunding, or using the Internet to sell equity to small investors. Signed into law as part of the Jumpstart Our Business Startups Act of 2012, the Securities and Exchange Commission released final regulations in October 2015. The regulations took effect on May 16, 2016. "Regulation Crowdfunding" offers small businesses the chance to raise up to $1 million a year through Internet-based funding portals, provided certain criteria are met. For more information, visit the SEC's website at www.sec.gov.

I. Employee stock ownership plan (ESOP). If you have employees, you might be able to sell stock directly to them. Employees participating in an ESOP are equity investors. In return for a reduction in salary or in fringe benefits, the employees may be given an ownership interest in your business — an incentive that helps motivate them to make the business a success. An ESOP will not be an option for many startups that do not have employees. For more information, ask your attorney or accountant, or contact the ESOP Association at 866-366-3832. You can also visit the organization's web site at www.esopassociation.org.

J. Private placement. A private placement is less complex than going public and involves selling shares of stock to a select group of equity investors. The investors typically exercise control over the company in direct proportion to the number of shares they own. There may be state "blue-sky" or securities restrictions on the number of investors. Check with an attorney familiar with your state's laws.

K. Other sources.

- Customers. You might consider an early collection policy or an advanced payment arrangement. With an early collection policy, customers would be given an incentive to pay before a specified date, typically prior to the date by which your bills are due. A customer may, for example, be given a 1% discount if payment is received 10 days early. An advanced payment arrangement, on the other hand, would involve payment for a product or service prior to the customer's receipt of that product or service. For example, a new magazine publisher might contact potential subscribers and offer them a discount if they subscribe early. The funds collected may then be used for the publishing costs of the initial issue. Keep in mind, however, that any money received would have to be returned if the product or service is never rendered, lest you risk charges of fraud.
- Suppliers. You might be able to negotiate a deal with suppliers whereby they agree to wait several weeks for payment. In such a case, you would have time to sell the merchandise or provide your service and use the income to pay your suppliers rather than having to borrow to do so. Keep in mind, however, that this is surely an easier task for a large, established business than for a startup. Moreover, suppliers that do agree to wait for their money might not offer you the lowest price in town.
- Factors. You might also consider "factoring" — the sale of accounts receivable (money people owe you). The person or firm to whom you sell your accounts receivable is called a "factor." Again, however, factoring is typically a luxury available to large established firms rather than startups. In addition, a factor will buy only at a discount, the amount of which may depend upon, among other things, the size and success of your business.
- State and local government. Be sure to check with your state and local community governments. Both likely offer some type of technical or financial assistance to new businesses that operate within their borders. For more information, contact your local chamber of commerce.
- Leasing companies. Rather than purchase the equipment or supplies you need, which might require large outlays of cash, you can lease. The company from which you lease, called the lessor, allows you, the lessee, to use the equipment for a specified period of time. For this use, you will typically remit a monthly payment, as specified in the lease contract. The upside is the money you save because no purchase is necessary. One of the downsides of leasing, however, is that you have no equity in the equipment. When the lease terminates, you have to give the equipment back to the lessor — unless, of course, the lease contract permits you to purchase the equipment at termination. For more information, inquire about leasing at the same companies that sell the equipment you desire; they most likely offer leases as well.
- Federal agencies. If your business is high-tech, you might consider Small Business Innovation Research Grants. These grants are provided to qualifying businesses with proposals for new technologies designed to satisfy agency needs.

Competition for these grants, however, is quite heavy. Moreover, the initial qualification for the research grant does not automatically qualify a business for a developmental grant. For more information, visit the organization's web site at www.sbir.gov.

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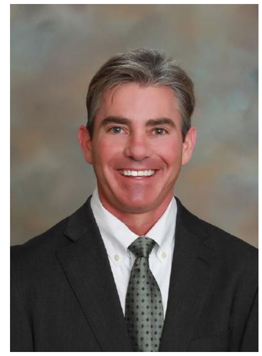

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