Sources of Financing

for Small Business Owners

Benefits and Risks

Barriers to Access: Low

Founder Investment

Initial and ongoing investment from the business owner

- ✓ You retain all control and limit the risk of intervention by creditors and investors.
- ! It will become more difficult to access outside capital as your personal funds diminish. Most lenders require the owner to invest at least 25% of project costs.

Love Money

Loans from friends and family interested in investing in the success of the owner

- ✓ Friends and family are typically patient investors who will accept smaller returns to see you and your business succeed.
- ! This type of capital may strain personal relationships. Always draft a written agreement to prevent miscommunication and future conflict.

Grants

Funds allocated to qualifying businesses to encourage economic growth

- ✓ Grants may be awarded to businesses in certain industries, and may not require repayment. However, they may require matching contributions from you as the business owner.
- ! Applying for grants is time consuming and rarely awarded to start-ups and retail businesses.
- ! Grants often come with performance goals and/or conditions that must be met

Barriers to Access: Medium

Bank Loan

Traditional debt taken out with a chartered financial institution

- ✓ Provided that your business has regular cash flow and has been profitable in the past, the bank may have lower interest rates than other creditors.
- ! This type of debt is usually secured. As a result, personal and commercial assets are at risk of seizure if you are unable to pay the loan.

Developmental Lenders

Creditors who take second position to chartered banks on more 'patient' terms

- ✓ 'Subdebt' lenders often extend patient payment terms (i.e. interest only periods) in exchange for an alternate benefit such as equity or future royalties.
- ✓ This category includes CFCWest. We often work with banks to help finance small business loans.
- ! Subordinated debt usually comes with equity requirements and/or higher interest rates

Factoring

Sell receivables at a discount to factoring companies for immediate cash flow

- ✓ The factoring company buys your receivables, and you receive cash immediately.
- ! Factoring can be very expensive and is more appropriate for large receivables.
- ! Factoring brings a third party into business transactions that may damage longstanding client relationships.

✓ Remember

Finding capital takes twice as long, and will be twice as hard as you might think. Plan ahead and start early. Waiting until you are desperate to search for capital means you will be negotiating from a weak position.

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Barriers to Access: High

Angel Investors

Private investors interested in obtaining equity in high growth start-ups

- ✔ Angel investors are often experienced business experts. They can be excellent mentors and may also offer access to valuable business contacts.
- ✔ Since they are investing personal funds, angel investors are flexible towards negotiations and unique terms.
- ! Angel investors are typically only interested in early-stage and/or high-growth business concepts
- ! Some angel investors are solely concerned with receiving a return on their investment.

Venture Capital

Equity financing through professionally managed funds

- ✔ Venture capitalists are experts in aggressive expansion and the creation of public companies.
- ! Venture capitalists are highly selective and will only consider high-growth innovative businesses
- ! Venture capitalists are mainly concerned with a return on their investment, and as a result may have a different perspective on how to run your business.

Private Placement

Sell shares to a number of private investors

- ✔ Reporting requirements are not as strict as with public companies and are less expensive to organize.
- ✔ Unlike venture capitalists, private placement investors do not expect high returns immediately.
- ! It is difficult to find individuals that qualify for private placements. They must either be close family and friends, or an accredited investor.

Initial Public Offering

Offer shares for public sale on the stock exchange

- ✔ Depending on the market, issuing additional shares is an effective way of raising capital without incurring debt
- ! Taking your business public is a time consuming and expensive process that will require the help of an investment banker and adherence to strict guidelines.
- ! There are ongoing reporting requirements to be met, such as audited financial statements, annual reports and maintaining investor relations

→ Financing Game Plan

Have experts in your corner

Attracting capital is good, but attracting capital *and expertise* is even better! Also consider assembling an advisory panel of experts to help you make critical business decisions.

Call the shots

Don't just approach one lender or investor. Approaching many simultaneously will keep your options open and help retain your bargaining power. Banks base loan terms on different criteria, so shop around and be informed!

Build a solid track record

The longer your company has been profitable in the market, the lower the risk it represents. Being seen as a lower risk will ultimately make it easier to access capital.

What's the stage of the game?

Understanding where your company is in its life cycle is important to ensure your company approaches the sources of capital that present realistic opportunities.

Keep your eye on the prize

Your search for capital will impact the long term success of your business. Do not hurry the process in an effort to find cash quickly. Complete research to find potential investors that fit with the vision of your business.

✔ A Note on Reinvestment

After several years of positive cash flow, it may be possible for you to reinvest retained earnings from the company into a new project. While this is a good way of keeping the business self-sufficient, it may prevent you from taking advantage of new opportunities due to lack of available cash flow.