

Suite 408**SECURING CAPITAL**

Securing Capital
Types of Capital
Equity Capital
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Banks & Banking
Glossary

408.01 INTRODUCTION

It is essential that in order to succeed in securing capital for your enterprise, and it should not only be the correct amount of capital but also it should be secured as the right type of capital. This section is devoted to providing you with the knowledge of the various types of capital and the various categories from which it may be secured. This is necessary as "You cannot solve a problem if you are unable to properly define it". So, let us be prepared to understand the types of capital, what stage your enterprise is at and where you might find your answer.

Once you have determined exactly what type of capital you are seeking we can help you find it. Capital sources are provided in Suite 804 on the 8th floor.

When you start a new business, you need money to get it off the ground. You need the money to rent or purchase space for the business, furniture and equipment, supplies, professional fees such as legal and accounting, as well as continuing the research and development of your product or service. You may also need money to pay employees. There are several places where you can get the money that a new business needs, but first you need to think about which type of funding will work best for your company.

Gone are the days of pitching investors with hot new technology ideas. Today, entrepreneurs are much more likely to dive into their own pockets and hunker down for a battle to start up and stay alive. But if you don't have the cash in your wallet, what do you do?

Start your capital search with a good business plan that shows investors and lenders your company's potential. Follow that up with a thorough knowledge of the resources available and a determination to make your business a reality, and you should be on your way to uncovering a source that fits your new business's cash needs.

TYPES OF CAPITAL

You have two choices when deciding which type of capital funding you want for your company. You can go for debt capital or equity capital.

With **debt capital**, you'll be getting a loan that must be paid back over a set period of time, with interest and possibly some other fees. You maintain full control of your company, but you also have a hefty tab to pay at the end of the evening.

Equity capital is funding provided by people or firms who want to own a part of your company and reap some of the rewards when your large and successful company goes public or is acquired by another larger and even more successful company. So, your real question is, do you want to give away part of your company in exchange for the cash you need to make it happen? Or, do you think you'll be able to make the monthly payments of a loan so you maintain full control and ownership?

To determine the type of funding you should go after, ask yourself questions like these:

For debt capital:

- Could my company even qualify for debt financing?
- Am I willing to lose my house if the company goes under?
- Will I be able to make the monthly payments to pay off the debt?
- Will the lender give me more money if I need it?

Or, for equity financing:

- Would investors even be interested in my idea?
- Am I really the control freak people say I am? Is that a problem?
- Am I really okay with someone going through my confidential financial information?
- Am I going to be able to give investors the information they need?
- Am I going to have a problem sharing my hard-earned profits?

Once you've mulled over those questions, and are totally confused, remember, you can always make use of more than one funding source.

You will probably be able to get more money from investors than from a loan. So if your business requires a lot of cash up front to grow quickly (as in a high-tech industry), then equity capital may be your best route.

EQUITY CAPITAL

408.02 UNDERSTAND YOUR POSITION

Let's look at the categories of capital you have to decide between. It is easier to understand exactly where you are if you understand the terms and definitions.

- **Seed capital** – Seed capital is the money you need to do your initial research and planning for your business. It is the money used for the initial investment in a project or start-up company, for proof-of-concept, market research, or initial product development. It is usually quite small because the venture is still in the idea or conceptual stage. Also, there's a high risk the venture will fail. Also called seed financing or seed money.

- **Start-up capital** – Early stage of business, typically no operating history. Investment is based on a business plan, the management group backgrounds along with the market and financial projections. It is typically the funding that will help you pay for equipment, rent, supplies, etc., for the first year or so of operation.
- **Angel Investors** – Traditionally, angel investors have been business owners or independently wealthy individuals that finance businesses in exchange for equity. Increasingly, however, angels are banding together into local networks that closely resemble venture capital groups. Angel investors will not only share their money; they're also great sources of knowledge for fledgling business.
- **Venture Capital** – Financing for new businesses. In other words, money provided by investors to start-up firms and small businesses with perceived, long-term growth potential. While most banks use past performance as the primary criteria for deciding whether or not to lend money to businesses, VC firms make investments based on projected future potential. Investors generally expect a substantial portion of the business' equity and/or profits. This is a very important source of funding for start-ups that do not have access to capital markets and typically entails high risk for the investor but has the potential for above-average returns. It can also include managerial and technical expertise. Most venture capital comes from a group of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships. This form of raising capital is popular among new companies, or venture, with a limited operating history and who cannot do so through a debt issue. The downside for entrepreneurs is that venture capitalists usually get a say in company decisions in addition to a portion of the equity.
- **Mezzanine Funding** – Mezzanine capital is also known as expansion capital, and is funding to help your company grow to the next level, purchase bigger and better equipment, or move to a larger facility. It can help a Company's progress to a position for an Initial Public Offering viable Venture funds are used to support the IPO.
- **Bridging Capital** – Bridge funding, as its name implies, bridges the gap between your current financing and the next level of financing.
- **Merger and Acquisition Funding** – Assists in the funding required in order to combine two or more companies, if one company survives, it is a merger. If both survive, it is an acquisition.

There can be several categories or stages all within the above title.

1. **Equity Loan** – An offer of an ownership position to induce the loan or can be a note that has an option to convert from debt to equity.

2. **First Round Funding** – Typically funding that accommodates growth. Company may have finished R&D. Funding is often in the form of a convertible bond.
 3. **Second Round Funding** – A maturing company where a future leveraged buyout, merger or acquisition and/or initial public offering is a viable option.
 4. **Later Stage Funding** – A mature company where funds are needed to support major expansion or new product development. Company is profitable or at minimum breakeven.
- **Small Company Offering Registration (SCOR)** – A SCOR is the sale of common stock to the public without the hassle of an Initial Public Offering (IPO) through a regulated board as the NASDAQ or AMEX. Unlike formal IPO's, in which all or most stock is sold and monitored through third parties, most companies involved in a SCOR deal directly with shareholders.
 - **Initial Public Offerings** – All offerings of stock and other securities are subject to (in the U.S., and similar in other countries) the federal securities laws, as well as to the securities laws of any state where the securities are being offered or sold. Unless there is an exemption that applies to a given situation, these laws generally require that an offering go through a difficult securities registration process.

DEBT CAPITAL

408.03 USING YOUR ASSETS

If you are prone to using your assets rather than giving up a percentage of ownership then the following are just a few ideas you may think about:

- **Equipment Leasing** – Also known as lease financing, this is an excellent way to finance your start-up if your primary need for the cash is to buy equipment. When you lease equipment, you make a monthly payment, but usually have the option to buy the equipment at a fairly decent price at the end of the lease. Also, by leasing your equipment, you'll be adding no burden to your balance sheet because leases aren't listed. You may also improve your chances of getting other loans because you're building a credit history with the lessor.
- **Factoring** - Factoring allows you to collect cash immediately based on your accounts receivable. If you've had problems getting funding from other sources, then this might be an answer for you. With factoring, you are basically selling your receivables at a discount, so you're not collecting as much as you would if you waited until the customer paid, but you get the cash immediately and can put it back into the business. Firms who offer this service may charge from 2% to 10% based on the amount of the total receivables, and then they are responsible for all collections.

- **Convertible Debt** - Convertible debt can be good for everyone (as long as you don't mind handing over a piece of the pie). It sets an environment for your lenders that will let them monitor your company's progress, and if your company does well then they have the option of converting their loan into an investment.
- **Asset-sale Lease-backs** - This may work for you if you own a lot of expensive equipment, but have little cash. You can sell your equipment to someone who will then lease it back to you. You get the cash inflow for your company and pick up a monthly payment for the equipment lease. In some situations it is ideal.
- **Purchase Order Advances** - As a last resort, you can sometimes use customer purchase orders to gain some funding. A lender may advance money for sales based on purchase orders you hold. This type of funding has high rates, so use it wisely.
- **Limited Partnerships** - You can form a limited partnership for your company. This sets you up (typically) as the general partner who bears all of the financial risk, while allowing your limited partners to invest funds but not be held liable for losses other than their original contributions. Check with your state's requirement for limited partnerships.
- **Private Placement** - You can offer stock in your company privately without having to register your company under federal securities laws. Check with your state's requirements and have your attorney look into it. Typically, you can use private placement for stock offerings of up to \$3 million or 35 investors.
- **Employee Ownership** - You can also offer ownership to your employees. In order to do this, however, your company has to be set up as a partnership or as a corporation. TIP: Be careful that you've selected your employees wisely.
- **Joint Ventures/Strategic Partnerships** - Match your product, assets, and needs with another company's products, assets and needs and pool your resources. Make sure the match is indeed made in heaven by having your attorney check out the deal and have any necessary documents drafted to protect your interests.

FUNDING CATEGORIES

408.04 WORKING CAPITAL

- **Business Micro Loans** These are working capital loans typically funded from \$5,000 to \$35,000 and used for any business purpose.

- **Credit Card Receipt Advances** A cash advance loan up to a \$100,000 that is secured against your regular occurring monthly merchant credit receipts. The loan is paid back via automatic deduction from future credit card transactions.
- **Sell Account Receivables** Your account receivables are purchased at a small discount and you get cash now.
- **Business Credit Cards** These loans are unsecured and usually do not exceed \$25,000. Loan limits are based on your personal credit score and not your time in business.
- **Sale and Leaseback** Sale of an asset for cash, with a contract to lease the asset back from the funding source purchasing the asset. Sales tax can be an issue here with this type of funding.

408.05 **SMALL BUSINESS LOANS**

- **Micro Loans** \$5,000 to \$35,000 small business loans that can be used for any business purpose.
- **USA - 7A:SBA Loan Guarantee** Loans to small businesses from private-sector lenders (banks, etc.) which are guaranteed by the SBA. The SBA has no funds for direct lending.
- **UK – Small Firms Guarantee** This is a loan for businesses which do not have a track record or the necessary security. The Government guarantees part of a loan of up to £100,000 for start-ups or £250,00 for established businesses that have been trading for 2 or more years. You can pay this loan back over 2 to 10 years and choose between a fixed or variable interest rate. You pay a premium to the Government.
- **Franchise Financing** Specialized financing reserved for the franchisees of recognized, typically nationally known, franchises.
- **Certified Development SBA** Loans to small businesses with long-term financing for major fixed assets, such as land and buildings. CDCs work with the SBA and private-sector lenders to provide the financing.

- **Fed-Export Assistance Loan** Export financing of U.S. goods and services through a variety of loan, guarantee, and insurance programs. (Import-Export Bank Programs)

408.06 COMMERCIAL FINANCE

- **Account Receivable Factoring** Account receivable factoring serves as collateral for short term working capital loans that you can obtain fast and cost effectively.
- **Asset Based Loan** Seeking to convert a company assets into working capital. Giving a security in an asset(s) in exchange for cash.
- **Bankruptcy/Reorganization** Financing to reorganize in company in a turnaround. Typically secured by assets; equipment, inventory, A/R, PO's, etc.
- **Expansion Financing** Growth has outpaced existing business. Loan for existing demand. Key here is existing demand, not projected.
- **Import and Export** Loans to promote the shipping or receiving of products or materials. Based on existing market, demand or orders.
- **Inventory Loan** A loan typically made as part of a relationship where the lender will also provide retail financing for the product.
- **Purchase Order Financing** Loans on the written order to purchase goods at a stipulated price with an agreed to delivery date. Credit rating or purchaser is key.

408.07 EQUIPMENT FINANCE

- **Equipment Loan** Making of a loan using the equipment as collateral. Good operating history, credit rating, debt ratios are the keys.
- **Equipment Leasing** Contract for a fixed period of time in exchange for payments, usually in the form of rent for equipment. Typically lower credit requirements.

- **Municipal Equipment Leasing** A lease transaction with any government agency (i.e. Federal, State, County, City etc.)
- **Equipment Sale and Leaseback** Sale of an asset for cash, with a contract to lease the asset back from the funding source purchasing the asset. Sales tax an issue here.
- **Credit Secured Line** A pre-arranged amount of credit based upon existing inventory, A/R and PO's.
- **Merchant Account Advance** Up to a \$100,000 advance against regular occurring monthly merchant credit receipts.

408.08 COMMERCIAL MORTGAGES

- **Acquisition and Development** Raw land infrastructure development (streets, utilities, etc.)
- **Adjustable Commercial Mortgage** Interest moves with a specific index (Prime, T-Bills, etc)
- **Construction Mini-Perm** Construction with 3 to 5 year loan, usually on income property
- **Construction Loan with Take-out** Construction with pre-arranged takeout loan in place.
- **Fixed Rate Commercial Mortgage** Interest Rate remains constant throughout the term.
- **Hard Money Loan** Loans from private lenders based primarily on the hard asset value (commercial building, vacant land, etc.)
- **Interim Loan** A short term (2 yrs or less), bridge or project type loan.
- **Joint Venture** A financial partner in the development of real estate.
- **Participating Mortgage** Lender receives a kicker for gross income above a present level.

- **Real Estate Sale and Leaseback** Lender purchases land and leases back to borrower (generally developer) for a fixed rent plus other considerations. Mortgages are issued on leasehold at market rates. Usually, produces more dollars than a mortgage.
- **Real Estate Purchase Loan** Lending for the purchase of commercial real estate.
- **Second Mortgage (Commercial)** Loan secured by equity behind that of the first lien.
- **Wraparound** Lender makes a second mortgage and assumes the first mortgage.

BANKS AND BANKING

Many businesses start and prosper without any outside finance. Others – either at the beginning or later – need some. Will your business need working capital? Will you deal mainly in cash, or credit? Will you want the flexible borrowing power of an agreed over-draft? Or will you need a loan to buy equipment such as machinery or vehicles, or premises?

If you need to borrow money, and are already in business, your bank will want to see copies of previous years' accounts together with any other relevant financial information you have. This might include tax records, Cash flow Forecasts, a list of your present debtors and creditors and so on.

If your business account is not already with the lender, you will need to show your previous bank statements. Your current account balance should match the opening bank figure in the Cash flow Forecast you produce for your business. It is always helpful to give your Business Plan and any other information to your bank well before your formal discussion with the manager. This gives the bank time to consider your proposal.

If your bank makes a decision to lend you money it will be based on the prospects of your proposed business and whether it will be able to pay back the loan from profits. However, there is always an element of risk. Depending on how much risk the lender thinks there is, you may need to give security as insurance against things going wrong. Be prepared to look at what business and personal assets you have.

If the lender needs security but your assets do not cover the amount you want to borrow, don't panic. The bank could still be able to help you by using on the governments Small Firms Loan Guarantee Schemes.

How much finance do I need?

It is easy to underestimate the amount of money you will need to get going. No bank wants you to have a bigger loan than you need, but not having enough finance is one of the most common problems in small business, and can be fatal.

Carefully filling in your Cash flow Forecast is the best way of estimating how much you will need.

You should be able to assess your overheads fairly accurately, but your first cash flow forecast is unlikely to be an exact reflection of the way your financial year works out in reality. Even so, you should break the year down into monthly financial periods, and assess how your income and outgoings will compare in each period. This will allow you to see when your borrowing requirement is going to be greatest.

Remember that a bank will be more likely to back you if you are putting the same amount of money into the business yourself.

What do you want the money for?

Say exactly what you want the money for. The money you need to run your business day-to-day usually comes from an overdraft. The kind of money used to buy premises or plant and machinery is usually arranged through a bank loan. When you take out a loan make sure the repayment term is the same as the working life of the asset.

Your 100 per cent commitment to the business is essential. Your bank manager will base the decision on whether or not to lend to your business on his or her assessment of your business plan. Ultimately the decision has to be a financial one. But if you present your plan to the bank on the back of an envelope it may indicate that you have an un-business-like attitude which is unlikely to impress your potential customers. So try to –prepare your business plan in a clear, professional way. Clarity and simplicity are the key words.

A Line of Credit

A line of credit is designed to provide short term funds to a company in order to maintain a positive cash flow. Then, as funds are generated later in the business cycle, the loan is repaid. Most commercial banks offer a revolving line of credit, where a fixed amount is available.

Conventional Business Loans

Traditional loans, often called “Long Term Debt,” are often popular initial financing venues for businesses competing in a proven field. Lenders often include government-sponsored lending programs, commercial banks and small business investment companies.

408.09 APPROACHING THE BANK

Every bank and every banker will have a slightly different idea of what to look for when deciding whether or not to lend you money. They will all, of course, look at

your financial projections and credit history, but their perception of your character is also a very critical factor. It may take many visits to many banks and many different bankers to actually find one that will take a chance on your business. So, don't give up too soon!

- Call first to make an appointment.
- Dress for success.
- Have a well-prepared business plan and all financial documents with you.
- Be professional.
- Be overly prepared to answer questions about anything and everything related to your business, your credit history, and your financial status.
- Show extreme confidence
- Be very "matter-of-fact" – present an air of not being desperate for the money
- Be truthful about everything (they're going to find out anyway).
- Don't spend your time "selling" your business idea (they don't care)
- Keep in mind that they only want to know how they're going to get their money (and interest) back out of you. However, your plan must provide them with the confidence required for them to make the decision.
- The larger your own financial investment in the company is, the better your chance of getting the loan.

GLOSSARY

- **Asset** Any item owned by an individual or company that could be converted into cash. This includes stock, vehicles, office equipment, real estate, accounts receivable, etc.
- **Asset-Backed Borrowing** Secured business loans with assets pledged as Collateral
- **Asset/Equity Ration** Total assets divided by the shareholder's Equity
- **Collateral** Assets that a borrower pledges in order to secure a loan or other credit. Those assets can then be taken in the event of default of the loan.
- **Co-signer** Someone other than the borrower who signs a promissory note in doing so, this person assume equal liability for the loan.
- **Debt Capital** Debt capital divided by total capital
- **Dilution of Ownership** The reduction in share value resulting when additional shares of common stock are issued, or convertible securities are converted. This equally reduces each shareholder's ownership of the company.

- **Equity Capital** Capital raised from a company's owners. Equity financing is done through the selling of common stock or preferred stock to investors.
- **Fund** A pool of money collected by investment companies from individual investors for purchasing securities in various companies.
- **Personal Guarantee** The guarantee from the owner that in the event that the company cannot pay the loan, he or she will assume personal responsibility for it.
- **Post-Money Valuation** The value of a company right after its latest round of financing. This amount is equal to the number of outstanding shares multiplied by the share price from the latest financing.
- **Pre-Money Valuation** The agreed upon value of a company right before its latest round of financing.
- **Promissory Note** An IOU, or promise, to pay back money borrowed it usually takes the form of a signed agreement between the lender and the borrower and specifies all of the terms of the loan.
- **Secured Loan** A loan backed by hard assets as collateral. A creditor may seize the assets used as collateral in the event of an unpaid loan.
- **Unsecured Loan** A loan not backed by hard assets as collateral, but solely on good credit of the borrower.
- **Valuation** The process of determining a company's (or Asset's) current value.