FUNDING OPTIONS FOR YOUR START UP IN TODAY'S NEW ECONOMY
by Pamela M. Belyn

Congratulations! You have decided to take the extraordinary step of starting your business. Now, like many an entrepreneur before you, you just need to find the money to fund your dreams. Below is a list of a few sources to fund your business. The list is by no means exhaustive but should give you a starting point from which to research funding options your business.

1. **Bank Loans**. To paraphrase an old joke, "You can get as much money as you need from a bank as long as you can prove you don't need it." In this post-banking crisis lending environment, truer words were never spoken, especially for a business with no operational history. However, for a start-up, bank loans may be difficult but not impossible to obtain. Bank loans are more readily available if your new venture has equipment, real estate or other tangible assets that can be provided as security for a loan or line of credit. Also, be prepared and willing to offer a personal guaranty for any loan request. You may not qualify for a loan today but there is always tomorrow. In the process of inquiring and applying for traditional loan financing, use your commercial banking officer as an information resource. Use a meeting with your banking officer to determine lending and underwriting criteria so you will be prepared for traditional financing once the business has a couple of years of operating history under its belt.

2. **SBA Loans**. The Small Business Administration is one of the few readily available loan sources for small businesses in this economy. However, the loans offered by the SBA are not the panacea to overall tightness in the lending market place but they do offer some options to small businesses. The SBA has three main loan programs targeted to small businesses: 7a, Microloan and CDC/504. The 7(a) program lends to certain eligible operating businesses. However, the 7(a) program has underwriting criteria, among which is an operating history, which may not lend itself to start ups.

   The Microloan program, on the other hand, is geared toward start-up and early stage businesses. However, loans under this program are made available through nonprofit, community-based organizations that have certain eligibility criteria which could range from business type, job creation, training and business planning requirements.

   If you are a small business looking to purchase equipment, real estate, improvements or certain other tangible assets for your business, then the CDC/504 program may be a good fit. There are lenders who specialize in these types of loans and would be happy to assist a start-up company in finding the correct SBA program.

3. **Business Self-Funding**. If your business has made a few sales or has customers waiting for your new widget, then factoring may be an option to raise cash. There are different types of factoring the most common of which are factoring for accounts receivables and purchase orders. If you have unpaid balances on customer accounts, finance companies may be willing to immediately provide up to 90% of the face value of the receivable in cash versus waiting 30-60 days for collection from the customer. However, accounts receivable factoring is based upon a wide variety of underwriting criteria which may significantly reduce the immediate cash realization. If you are selling to larger, established and credit worthy companies then fewer of your receivables will be deemed "ineligible" due to credit criteria.

   Finance companies may also be willing to advance funds on large purchase orders. For example, you receive a large order for widgets from a new customer but need the proceeds from the purchase order to obtain raw materials, then purchase order financing may be a viable option. For a percentage generally based upon the purchase order value, you get the cash upfront to fulfill the order and your customer pays the finance company.

   As with any form of financing, you would be wise to hire experienced counsel to read the fine print on any agreement to ensuring your rights are protected and you are getting what you think you are getting under the agreement.

4. **Personal Financing**. Using personal funds to start some portion of your business should be a go to first step for every new business. It is always a tough sell to convince outside sources to invest in your business if you have not put any of your own money into the venture. Think of your sources of such funds such as savings, cash, 401(k) loans, severance payments, credit cards, signature loans from credit unions, second mortgages, home equity lines, couch change, giving up your designer coffee for a while, the list can be as creative as you are.

5. **Friends and Family**. Friends and family can be the best and worst source of start-up funds. This cast of characters is usually just as excited about your start-up idea as you are. They are willing to open their hearts and checkbooks to help you become a success. But how are you going to formalize the relationship so Christmas, Hanukah, Ramadan or a host of other family celebrations do not become awkward family celebrations? Treat friends and family as unrelated third parties and formalize any loan or equity investment. Do not take any more cash than such friend or family member can afford to lose. While is it tempting to use the $150,000.00 offered by Aunt Sue, make sure those funds do not constitute her life savings. Also consider limiting everyone in this category to the similar amounts so as not to play favorites or feed any negative family monetary dynamics.

Next, decide upon whether or not the investment will be a loan or equity. If it is a loan, document the loan as if the lender is an unrelated third party. Use a promissory note, security agreement (if the loan is secured by the business assets) and other formal documentation. Be diligent in keeping the loan and/or interest payments (if applicable) current. If it an equity investment, then consider using convertible promissory notes (loans that convert to equity in the company upon securing formal financing) which allow later investors to value to price of equity thereby curbing any disputes over valuation with family members.

Above all else, keep this group of initial investors abreast of events that affect the business, good or bad. Information can be the key to defusing any hard feelings about a negative outcome for their investment.

6. **Incubators**. There are a handful of early stage "incubators" around the country, mostly focused on tech related industries. These incubators take generally take what can best be described as a "parental" interest promising companies or ideas. The incubators may provide co-location, access to office space, staff, attorneys, accountants or other advisors and generally assist the company with initial development in exchange for equity. This is good for tech companies because of the high initial costs that can be associated with software/product development. The participant company gets financial support from the incubator as well as advice which could serve the company well as it progresses through the start-up process. California is generally the hot bed of tech incubators but tech and other incubators are cropping in in cities all over the country.

7. **Crowdfunding**. The Jobs Act of 2012 paved the way for small businesses to raise money from the public ("Crowdfunding") without running afoul of registration requirements of the Securities Act. However, the Securities and Exchange Commission has yet to promulgate and finalize rules pertaining to crowdfunding from non-accredited investors and the general public through the use of such portals.

   Crowdfunding can take the form of advanced sales, debt financing or equity financing. It is best to use a previously established crowdfunding portal to assist in your fund raise to reduce the risk of running afoul of any existing securities laws. But beware of some risks and hidden costs associated with crowdfunding. For example, possible litigation over failed investments, reluctance of traditional private equity or other financing sources to value or want to invest with the "public" or unsophisticated investors, unknown cost associated with crowdfunding compliance, etc. Until the rules have been established the list of potential pitfalls is endless.

8. **<u>Bartering</u>**. Old fashion, yes, but effective. Is your new product or service in demand? Do you have a particular talent that can be exchanged for other services. For example, Widget Maker A knows that Company B, who sells widget raw materials needs a website overhaul. Widget Maker A offers the services of its in house developer for free in exchange for widget raw materials. The permutations are endless and the worst someone can say is no.

Hopefully, this list will get your creative juices flowing and you can come up with additional sources of funds for your business venture.

Pamela Mitchell Belyn is Of Counsel at Boodell & Domanskis, LLC in Chicago, Illinois. Ms. Belyn serves as outside general counsel to several middle market businesses in various industries. With a primary focus on the middle market, Pamela counsels clients on all aspects of legal operations, including corporate transactions, corporate governance, commercial finance, employment law, litigation, contract administration, real estate and risk management. Pamela also provides counsel to various entities seeking Women-Owned Business Enterprise, Minority Owned Enterprise, or Disadvantaged Business certification and provides representation on appeals from adverse certification decisions.

Pamela Mitchell Belyn
T: 312-219-8539
pbelyn@boodlaw.com
Boodell & Domanskis, LLC
353 North Clark Street, Suite 1800
Chicago, Illinois 60654