SOURCES OF CAPITAL

New businesses must be capitalized carefully. Entrepreneurs must identify their start-up capital needs and their cash flow through their break-even point. The total of the two, plus a healthy "just in case" reserve, add to the total amount needed to open the doors of a new firm. **Never** sell short the amount of money it takes just to get started! It is certain to be a lot more than you expect at first.

1. KINDS OF MONEY

When you plan the capital requirements of your new firm, you can consider two forms of money.

a. **Equity** is ownership in the business. It can come from you, or from someone else. Since it is ownership, it implies a degree of risk, and an element of control over the conduct of the business. If you sell an equity share to someone else, they could lose their money if the business doesn't work out. And, it is likely that they will want to have some say in the way the business is run. If you aren't willing to give up some control, then a co-owner (sometimes called a "silent partner") may not be for you. It's amazing how people seem to change after they have given you some of their money.

b. **Debt** is a loan you take out. As such, it must be repaid. There are many sources of borrowed money, but remember that in every case, you must pay it back according to mutually agreed upon terms. Moreover, loans usually involve interest – a charge you pay for the rental use of the money.
Be aware at the beginning that the majority of your original start-up capital will probably have to be **equity**, simply because most lenders don't want to assume the risk involved with a new, untried, unproven business venture. The statistics are grim:

- Most new businesses don't make it - estimates are as high as 75% in the first year.
- Lenders are not usually good risk-takers; they like security usually require 25-35% collateral for new businesses.

Most of your money will be equity; some (if any) might be debt. Know up front, however, that there is almost no way you will be able to finance your entire venture without debt. (Unless you have a favorite rich relative with excess money they want to give you.)

2. SOURCES OF START-UP CAPITAL

With that in mind, here is a list of sources you might consider for your start-up money.

a. **Individuals**

- Yourself
- Savings
- Home Equity (Mortgage)

- Life Insurance cash value
- Sell or mortgage other personal assets (boat, motor home vacation house…)

b. **Other Individuals**
- Relatives
- Friends
- Other local Investors
  - Intense competition for funds
  - Risk vs. Return
  - Basic Conservatism (fear of loss)
  - Ownership = control

Note: If you get money from these sources, be sure you know whether you are selling equity in the business or if it is a loan, which you must repay.
Note: If you get money in the form of a loan, follow the example set by Lee Iacocca with his government bail-out loan: **Pay it back early!**

c. Sell Stock (Ownership)
- See a lawyer!
- Consider a "Close" corporation – easier, less rigid formalities.
- Venture Capital firms – good for high-tech and/or high-growth, multimillion-dollar ventures within three to five years. Otherwise, little chance. (See Venture magazine)

3. SOURCES OF BORROWED CAPITAL (Debt – from short-term to long-term)

a. Trade Credit – Borrow from your suppliers for your inventory needs. 30 – 120 days possible. Be sure to pay on time or early.

b. Equipment Leasing – Low down payment, fixed monthly payments; deductible expense.

c. Equipment Loans – Borrow, using the equipment as collateral (just like your car).

d. Banks – For a single sum
- **Very** conservative! Risk averse. They want a two-to three-year success track record.
- They will require collateral – and personal guarantees in addition to business ones.
- They will advance only a small part of the total business needs.
- They may require a solid co-signer who will also become liable to repay.
- They will demand **full** details of the business – and your **personal** finances.
- In sum, banks are **not** in the business of making start-up capital loans.
- **BUT:** Consider **Franchising** – many have good relationships with lenders.

4. FEDERAL PROGRAMS

a. **Certified Development Company (504) Loan Program**

The 504 Certified Development Company (CDC) Program provides growing businesses with long-term, fixed-rate financing for major fixed assets, such as land and buildings. A Certified Development Company is a nonprofit corporation set up to contribute to the economic development of its community. CDC's work with the SBA and private sector lenders to provide financing to small businesses.

Typically a 504 project includes a loan secured with a senior lien from a private-sector lender covering up to 50 percent of the project cost, a loan secured with a junior lien from the CDC (backed by a 100 percent SBA-guaranteed debenture) covering up to 40 percent of the cost, and a contribution of at least 10 percent equity from the small business being helped. The maximum SBA debenture is $1,000,000 for meeting the job creation criteria or a community development goal. Generally, a business must create or retain one job for every $35,000 provided by the SBA. The maximum SBA debenture is $1.3 million for meeting a public policy goal. Proceeds from 504 loans must be used for fixed asset projects such as:

- Purchasing land and Improvements
- Construction of new facilities
- Purchasing long-term machinery and equipment.

b. **Small Business Administration 7a Loan Guarantees**

The 7(a) Loan Guaranty Program is one of SBA's primary lending programs. It provides loans to small businesses unable to secure financing on reasonable terms through normal lending channels. The program operates through private-sector lenders that provide loans that are, in turn, guaranteed by the SBA – the SBA has no funds for direct lending or grants.

The maximum dollar amount the SBA can guaranty is generally $1 million. Loans of $150,000 or less carry a maximum guaranty of 85 percent. For loans greater than $150,000, the maximum guaranty is 75 percent.

The proceeds of SBA loans can be used for most business purposes. These may include the purchase of real estate to house the business operations; acquisition of machinery and equipment; purchase of inventory; and working capital.

Maximum loan maturities have been established: twenty-five (25) years for real estate and equipment; and generally seven (7) years for working capital.

Interest rates may be fixed or variable. Fixed rate loans of $50,000 or more must not exceed Prime Plus 2.75 percent if the maturity is 7 years or more.

c. **SBA LowDoc (Low Documentation Program)**

Once a small business borrower meets the lender's requirements for credit, the lender may request a guaranty from the SBA through SBA LowDoc procedures. It's a quick, two-step process: the borrower completes the front of the SBA's one-page application, and the lender completes the back. The lender submits a complete application to the SBA and receives an answer within 36 hours.

Interest rates can be negotiated between the borrower and lender, may be fixed or variable, are tied to the prime rate and follow 7(a) interest rate structure.

To secure the loan, the borrower must pledge available business and personally owned assets. Loans are not declined when inadequate collateral is the only unfavorable factor. Personal guaranties of the principals are required.

Maturity is usually 5 to 10 years. For fixed-asset loans it can be up to 25 years. A business is usually eligible for SBA *LowDoc* if the purpose of the loan is to:

- Start or grow a business and the existing business employs no more than 100 people.
- The business has average annual sales for the preceding three years not exceeding $5 million.
- The business and its owners have good credit.
- The business owners are of good character.

5. **PPEP Micro-business Loans**

PPEP provides low-income individuals, families and communities greater opportunities through better access to local capacity-building resources and affordable financial products.

Micro enterprise loans up to $25,000 are offered for borrowers for working capital, inventory and equipment with a term of 5 years. Loans are for $500-$25,000.

MICRO lines of credit for micro enterprises that have repaid at least one pervious micro-loan. Lines of credit are available for $3,000 to $25,000.

Inventory and working capital financing for wages, utilities, overhead, advertising, accounting and bookkeeping services, purchase of inventory, light materials and other expenses that are associated with operating a small enterprise. $500-$25,000.

Bridge loans of up to $75,000 provide working capital and fixed-asset loans for successful, maturing micro enterprises capable of sustaining larger loans, as demonstrated by successful repayment of multiple micro-loans.

Small business loans up to $150,000 to finance business facilities and community development projects in rural areas and the expansion of existing businesses, creation of employment opportunities and saving existing jobs.

6. **Chicanos Por La Causa, Inc.**

Chicanos Por La Causa is a non-profit Community Development Corporation dedicated to providing social services, economic development, youth enrichment and special events to Arizona. Its programs are designed to address the causes of poverty within the neighborhoods it serves.

Rural Development Loan Fund (RDLF) provides capital to existing businesses for investments that create, maintain or enhance employment opportunities for low-income persons. Loan funds are available from $20,000 to $200,000.

Micro-Loan Program addresses the problems encountered by small business entrepreneurs seeking financing, and provides alternatives to existing and emerging micro-enterprises among the communities in Arizona, thus increasing the potential for success of those businesses in Chicanos Por La Causa’s target areas. The Micro-Loan program offers loans from $2,000 to $25,000.

The URBAN LOAN FUND Program is a special revolving loan program that is being leveraged by a local bank. The program is designed to help small business in Maricopa County secure funds. Chicanos Por La Causa will guarantee up to 33% of the loan amount to make the request bankable. The loan amount can range from $10,000 to $50,000.

7. **Self-Employment Loan Fund, Inc. (SELF)**

The Self-Employment Loan Fund, Inc (SELF) serves as an intermediary and bridge for those persons getting started in business who are not quite ready for traditional business and lending opportunities. SELF provides training, technical assistance, and access to micro-loans in a three-tiered program that covers areas critical to business success.

Peer Lending Program:

- A Borrowers' Circle is comprised of five to eight business owners who are starting their businesses.
- Initial loans can be up to $1,000 with 12 months for repayment.
- Subsequent loans can be up to $5,000 with up to 24 months to repay.
- Peer Loans require the completion of SELF's business plan workshop and active participation in a borrowing circle.
- Peer Loans do not require collateral or credit checks.

Individual Lending Program (ILP) loans range from $3,000 to $15,000 with up to 36 months to repay and are available to qualified business owners who:

- Have operated a business for a minimum of 2 years.
- Have a complete written business plan.