

Most Common
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16 Ways to Get Money for your Small Business (Plus One Bonus Idea)

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**HAWKEYE
MANAGEMENT**

Business Capital Without Collateral

Introduction

Small businesses need capital to grow.
But what's the best way to get it?



I've helped thousands of small business owners find the cash they need to start, build, and grow their businesses. In my experience, business owners make many mistakes in borrowing money — they pay too much in interest, don't get the best terms, get the wrong type of loan, hurt their credit, or fail to take advantage of the tax breaks they should get as a business borrower.

These mistakes happen mostly because entrepreneurs are experts in what their business does, but not in the world of credit and lending. They don't know all the options -- all the different ways they could obtain funding.

There are many different ways to get money for your business, but obtaining business capital really boils down to two basic categories: You're either giving up **equity** in your business or taking on **debt**.

This list could have been much longer. However, these are the "most common" financing solutions for small businesses and it's not meant to be an exhaustive list of every imaginable way to raise money. The financing solutions herein probably make up 90% of all capital that is obtained by small business owners.

Within those two categories—equity and debt—there are many variations. Here's a look at the 16 most common ways small business owners get capital in today's economy (plus one bonus method).

Equity

Giving up an equity stake in your business means your ownership of the business is reduced. As the business grows and becomes more successful, investors will share in those profits.

Once you take on equity investors, it also means the pressure builds for an “exit” event that would pay off those investors -- usually a sale of the business, public offering, or possibly a healthy dividend or distribution of profits.

Most business owners aren’t ready to give up an equity stake. If you’re interested in remaining in control of your business, it’s probably not for you.

But if you want to explore giving up equity, know that equity investors come in four basic flavors:

1. **Venture capital.** Many small-business owners dream of finding a moneyed venture firm to invest millions in their business. The reality: Only a tiny fraction of small businesses will ever secure a venture investment. The National Venture Capital Association reports only **1,000 businesses received a first-time venture capital investment in 2010** — that’s out of the nearly **6 MILLION American businesses** that have employees and out of 25-30 million total small businesses.



Most venture capital firms receive thousands of business plans each year and usually invest in fewer than a dozen.

So it’s a real long shot. Also, most VCs want a big stake in the business. When you add up the liquidity requirements and other investor rights the venture capital firm receives, the effective cost of capital can exceed 70%. You may also lose control of your company as venture investors gain a larger stake over time, and take more seats on your Board of Directors.

Most venture money goes to businesses in just a few industries, such as software, information technology, clean/green energy, and biotech. If you’re not in one of those sectors, you’re probably out of luck.

2. **Private equity.** Most private equity firms focus on bigger businesses, not small ones. But a few PE firms that concentrate on a particular sector might take an interest in a small business.

The problem: Most private-equity investors are bargain-shoppers — they look for established companies with a good brand name that are on the skids. They buy the company at a low valuation, pump in some money, clean it up, and sell it off at a profit.

Many prefer to buy a company outright, so you're basically cashed out of the business at a low number, and your connection to the business ends. Not a good choice for a business owner who wants to keep running their business.

3. **Angel investors.** Angel investors are a more realistic source of funding for most small businesses compared with venture capital and private equity. **Angels invested \$19 billion in 55,000 deals** in 2008, the Center for Venture Research reports.

You may personally know wealthy individuals who might provide some cash. There are also new online portals such as **MicroVentures**, **ActSeed**, and **BusinessPartners**, where you can try to connect with investors and negotiate an investment deal.



Like venture capitalists, angels sometimes want a voting seat on your company board, expect to have a say in major decisions you make, and they will want at least a piece of the business. Ever watch Shark Tank on ABC? When is the last time one of the sharks agreed to invest in a company and asked for less than 51% ownership? It's a great show and there's some truth in that, but angel investors will often take a smaller stake in the business.

One of the more popular strategies for angels is the convertible note. This gives the angel a debt position (sometimes first lien) that will convert to equity at a later time, at a discounted price set by the investor.

Most owners who take on angel money end up going public, doing a merger deal, or putting the business up for sale to generate the needed cash. **Angel investment** can be a good strategy for a business owner with a desire to exit the business in the short term. But pitching investors takes up a sizeable amount of time that you cannot spend focused on building your business.

4. **FFF - Friends, Family, (and Fools).** The “less sophisticated” equity investor can be a good channel for an initial seed round of capital, but a company must be careful in taking investment money from too many non-accredited investors – those with net worth of under \$1 million. This situation can lead to lawsuits and the risk of violating SEC regulations if owners are not careful. Despite some of the challenges, it’s a worthy investment segment if managed properly.



Debt

Debt is...well, pretty much everybody in America knows about this one. Your business incurs debt when you borrow money for your business needs. Then, you must pay that money back. Usually, you have to pay interest and make payments to get rid of that debt — and that debt impacts your company's cash flow.

It's important to borrow the right way and use your working capital loans and lines of credit for revenue generating activities. This way, you'll generate additional revenue and profit that will justify the additional debt that was created.

5. **Trade or Vendor Credit.** This may not be “cash” but it's most certainly a form of debt capital. It's very common and the normal terms are “net 30.” In other words, the local plumbing supply store lets Joe's Plumbing take \$2,000 worth of supplies for his commercial job. Then, they send Joe an invoice that requires him to pay the bill within 30 days.

6. **Credit cards.** Plastic is the most common way entrepreneurs get money for their business. According to the Meredith Whitney Advisory Group, **82 percent of small business owners use credit cards** as “a vital part” of their operations.

Credit cards are unsecured lines of credit. There are many highly-successful companies out there that got their start on the backs of the founders' credit cards.

However, here's the problem: having looked at thousands of credit reports, my experience is that most small business owners use their credit cards the wrong way.



Five things happen when credit cards are improperly used and managed by small business owners.

- ▶ *You don't keep your business credit separate from personal credit.* Using personal credit cards or the wrong sort of business cards means your spending will be reported on your personal credit, even though the money is used by your business. Getting a cash advance is similar to simply charging expenses with credit cards, except often the interest rate is substantially higher than your card's rate for regular purchases. And don't forget that when you take a cash advance, you usually won't be able to access your entire credit line, so your "access" is limited. Enough said, eh?
- ▶ *You don't build your business or personal credit ratings.* Ideally, you want payments you make to pay off business debt to help build your business's credit – but if you charge on the wrong type of card, it won't happen. Meanwhile, your personal credit is taking a hit as your company racks your card up near its credit limit.
- ▶ *Payments are too high.* When credit cards are not chosen carefully, when 0% offers are not taken advantage of, and when credit cards are not managed properly, then your cash flow will be negatively impacted because payments are too high. It's estimated that as many as 90% of people who select 0% offers on credit cards don't take proper advantage of those offers. Many people also treat credit cards like car loans and mortgages and pay them a few days late. Don't forget there's no "grace period" on your plastic, so you must manage it differently than your loans.



- ▶ *Interest rates are too high.* Many borrowers don't realize how high monthly interest rates on credit cards drain your business' cash. You can set up and manage your credit cards the right way or the wrong way. The two biggest things you can do to maintain low rates or improve your credit-card rates are to pay your bill on time and not go over the credit limit. Remember, it's NOT okay to pay your credit card bill a day or two late like your car loan or mortgage. This is the fastest way to penalty pricing of 20% or more. A properly managed credit card portfolio should not only get you 0% introductory offers but should also keep your average rate after the 0% offers end at somewhere south of 10%.
- ▶ *Fewer tax benefits.* Personal credit-card spending doesn't usually qualify for all the tax breaks a business loan or credit line would – for instance, a writeoff for interest and fees paid.

7. **Unsecured business line of credit.** Often, a UBL is the ideal debt vehicle for a growing small business. Rather than fixed monthly payments that stay high even when you've paid down most of the principal, a UBL can give you **access to up to \$100,000** or more without paying interest on money you're not currently using. As you make payments, they replenish the available capital so you can borrow it right back out again. This struc-



ture means monthly payments are usually relatively low, which helps with cash flow.

It's not easy to obtain a UBL, as many banks simply don't offer unsecured business credit lines. Since the downturn, many lenders that previously provided UBLs discontinued their programs.

Almost all banks offer business lines of credit, but rarely without collateral. It's the "unsecured" part that's difficult, and requires both the right bank and usually a skilled individual at that bank as well.

The lenders still offering UBLs are choosy about who they fund. It pays to have an expert on your side who knows the lenders and their application processes. These selective lenders look for good personal credit — usually a **FICO** score above 700. Lenders like established businesses with at least two years of financial history. Businesses in certain industries, including restaurant and real estate, aren't good candidates for a UBL.

8. **Commercial bank loan/SBA loan.** If you have great credit, an existing relationship with a business bank, and business or personal assets you want to pledge as collateral, an **SBA-guaranteed bank loan** can be a good choice. If not, finding a loan in the current tight credit market will be challenging.

Business-loan volume has plummeted since the downturn began in late 2008. Getting an SBA-backed loan can help lower your rate and make you more attractive to banks. But many business owners don't realize most SBA-backed loans require collateral – and that collateral is usually the business owner's personal residence, especially in the case of start-up businesses.

9. **Peer loan.** Websites such as [Prosper.com](#), [LendingClub.com](#), and [Raise-Capital](#) help individuals and businesses get unsecured loans.



The fundraising method is known as peer-to-peer lending, or P2P lending. You post your business story online in hopes of attracting many individual lenders willing to put up small amounts towards your loan total, usually just \$50 or so apiece.

If enough people buy in, your loan is funded at an interest rate determined by your credit rating and what the crowd is willing to accept. On most peer lending sites, the amount you can borrow tops out at \$25,000 – (\$35,000 for Lending Club).

This isn't magic money from the Internet, either, and there are some not-so-great aspects of P2P loans. As with a traditional bank loan, if you don't make your payments on time, the site you borrowed from will report your default to the credit agencies and have collection agencies on your tail.

Also, these are considered personal loans, so even if you request the loan for business purposes, it's going to be reported on your personal credit report – never the best thing for a business loan.

The other thing peer sites don't tell you is that the site reviews your credit application and may not approve it. In my experience, perhaps 10%-15% of applications get approved, so peer sites aren't that much more flexible than banks – I've had clients get turned down by the underwriting department even after getting fully funded by investors. Finally, many entrepreneurs that try P2P sites fail to attract enough lenders to fund their loan.

10. Home equity line of credit. HELOCs were popular back before the down turn. How times change.



In May 2011, more than **one-quarter of Americans** homes were “**underwater**” — that is, the owners owed more on their mortgage than their home was currently worth. Translation: Far fewer small business owners are able to tap HELOCs to fund their business now, because many have no accumulated home equity to withdraw.

Maybe it's just as well. Using home equity to fund your business was never as great an idea as people thought. When you borrow out of your house, if your business runs into trouble and you can't make your payments, you're at risk of losing your home.

11. Cashing out or borrowing from retirement funds. This is another popular way to fund a business, startups and new franchise units in particular. The problem with cashing out is fairly obvious: If you cash out your retirement funds, they don't continue to appreciate in value, and you don't have any money on which to retire! You're taking a huge gamble that your business will be a smash success and you'll be able to replenish those funds later.

Borrowing money out of a 401(k) or IRA to fund your business is possibly even worse. The IRS calls these transactions Rollovers as Business Startups, or ROBS transactions. ROBS work like this: You incorporate your business and create a 401(k) plan for the startup. Then you transfer funds from an existing retirement account to this new retirement plan. Then, you borrow out the money from your company plan to spend on business growth — tax free.

Does that sound a little fishy to you? Then you won't be surprised to learn **the IRS has taken a dim view of ROBS**. Though companies that help structure ROBS transactions swear by their validity and ROBS transactions are common — 4,000 were set up in 2009 — the IRS has warned it is actively reviewing these transactions and may decide many or all of them are illegal.



If that happens, all the money entrepreneurs have borrowed out of their retirement plans will have to be paid back in, plus interest and penalties. Moral of the story: Be very, very cautious about borrowing out of your retirement plans. Experts recommend simply cashing them out and paying the tax and early withdrawal penalty up-front if you must use that money for business purposes. Then you know you won't run afoul of the IRS later.

12. Equipment financing. If the money you need is for the purchase of a piece of business equipment such as company trucks, know there are specialized equipment lenders that can help. Rates for an equipment loan can



range from bank-rate to high cost, depending on the individual applicant's credit and the type of equipment.

Not all banks do equipment lending, and the ones that do will often require a down payment — and won't offer a leasing option. For these rea-

sons and many others, small business owners normally prefer non-bank equipment financing. Most banks don't want to end up repossessing a construction crane and having to market and sell it — that's not their business.

I often recommend small business owners consider leasing equipment rather than taking on long-term debt with a loan for an asset that may not have much resale value down the line. Leasing preserves your cash flow, as it doesn't require a down payment and usually little or no money "out of pocket."

In fact, I recently took my own advice on this and leased a new phone system rather than taking out a loan. I could have obtained a lower rate if I had gotten a bank loan. However, I would have needed a down payment, we would not have been able to lease the equipment, we would have missed out on valuable tax benefits, and the bank loan would have showed up on my personal credit report.

There are **tax advantages to leasing**, too, as you can write off the payments as a business expense. With a loan, you could possibly write off only the interest portion. Also, a bank loan hits your credit rating as a debt, where a properly structured business lease doesn't.

13. Merchant Cash Advance (also known as merchant financing or an MCA).

The merchant cash advance industry is growing constantly because the banks are unable to properly meet the needs of the American entrepreneurs. As an example, it can be very difficult for restaurant owners, seasonal businesses or franchisees, which use credit card processing heavily, to get loans from the traditional business financing institutions.

Why is that happening? The answer is simple: the banks will require tangible assets as collateral for their well guarded cash most of the time. This means that even the owner of a very profitable restaurant will have a hard time trying to get a traditional bank loan because he or she can't use perishable foods or used cooking appliances as a guarantee.

Another example: a franchisee that used all his money purchasing his very first franchise and is now interested in purchasing the second one will have a hard time trying to get a loan from a bank, but he won't have any problem applying for merchant financing.



For industries where much of the business comes through credit-card charges, merchant financing allows you to get a loan against those future sales.

As mentioned before, businesses that are shut out of factoring, such as restaurants, often use this borrowing method. Unlike factoring, merchant financing is a loan, but it's one for a sale that hasn't happened yet.

Basically, the cash provider will give the merchant an upfront cash advance, while the merchant agrees to repay the money by giving the business financing company a percentage of the sales until the balance is zero.

One advantage of an MCA is that usually there isn't a lot of documentation required – the acceptance is based primarily on your monthly credit-card sales history. Credit scores and company finances aren't much of a factor, so your credit does not have to be good. You'll need a track record of usually at least a year in business and at least a few thousand a month in credit-card charges.



Most business owners choose MCA's because this allows them to have access to cash quickly; under normal circumstances, the money can be available in one or two weeks. And unlike a traditional bank loan, where you have to pay a fixed rate no matter if your business is prospering or not, with merchant financing you will only have to pay a percentage from the daily sales.

This means that if the business isn't working that well, the payment will be smaller; on the other hand, if the business is thriving, the owner will be able to repay the loan much faster.

An "average" merchant financing loan would be around \$30,000 and would be paid back over six months at a factor of 1.3 to 1.4. This means you pay back 30%-40% more than you borrowed over a six- or nine-month period of time. It might look a bit too expensive, but let's not forget that the lender is taking on a lot of risk, because it is betting on your company's success.

In addition to this, if those funds are used to build the business and increase revenue, or even to help you go through tougher times without shutting down your business, merchant financing really is a lifesaver, especially if you don't have other lower-cost borrowing options.

It's important to note that in recent years some variations of MCA's have hit the market. They are mainly bank-statement driven and are usually slightly better priced than MCA's. They also do not require businesses to accept credit cards (unlike MCA's). Much like MCA's, however, they are looking for cash-flow and not high credit scores.

14. Factoring. Though you often hear this referred to as getting a “factor loan,” it isn’t a loan, really. In factoring, **merchants sell their outstanding receivables** to a factor lender at a discount. Receivables become assets of a company once you actually deliver a product or perform a service and invoice another business or government entity. You can sell this asset just like any other asset of your company.

The factor lender takes a percentage of your outstanding receivables as their fee. This compensates them for having to wait around for those payments to roll in a month or two from now, as well as for the risk the lender takes that some of your customers might be deadbeats and not pay up.



Common uses of factoring include: making payroll, working capital for growth, and taking on a new client you would have otherwise turned away due to lack of operating funds.

The advantage of factoring is that it’s usually very fast compared with getting a traditional bank loan — just a few days sometimes and the money is in your hand. The lender immediately pays you the total due, minus their cut.

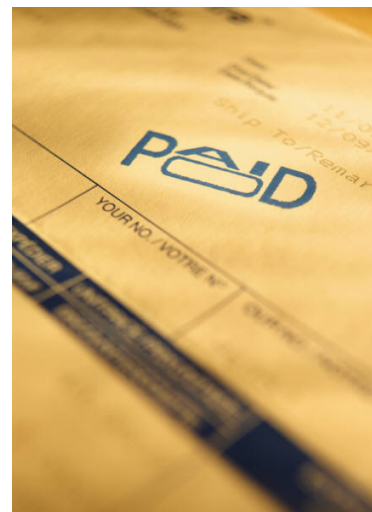
One question you can ask yourself to determine if factoring makes sense to you is, “would you be **HAPPY** to accept payment for your services if your clients would agree to pay you via Visa, MasterCard, or American Express?”

In most cases business clients demand terms of 30 to 90 days and would never agree to pay with a credit card. The reason to ask the question is that often factoring fees are similar to the amount processors charge merchants (2% to 5% depending on volume, risks and terms). So if you can afford to take the loss of the points charged by a merchant processor, factoring may fit your budget.

This brings us to the disadvantage of factoring which is giving up a substantial cut of your profits. When applying with factors, there are a number of reasons you may or may not be qualified for a factor loan. For example, some industries are viewed unfavorably by factors, such as construction or medical businesses that bill insurance companies for payment.

Like any non-bank lending solution, there is a time and place for factoring, and it can really help some businesses. Every day you don't get paid for the work you've done costs you money, so getting access to those funds sooner rather than later can often be a wise decision, despite the higher cost associated to factoring.

15. Purchase order finance. P.O. financing is often confused with factoring, but is as different as night and day. Instead of selling receivables for merchandise you've sold or a service you have provided, money is advanced to you so you can pay for goods for which **you have a firm purchase order** from a major customer, usually a big retailer or government agency. So instead of selling an asset of your company, you are actually getting an up-front advance prior to any product or service being delivered.



An example of P.O. financing is a value-added manufacturer in Missouri who sells shirts to Bible bookstores. The manufacturer uses a P.O. funder to pay the shirt manufacturer in China for the shirt stock to be shipped to the U.S. Once the shirts arrive in Missouri, they are imprinted for the end retailers, shipped, and then the retailers are invoiced for the shirts.

The risk for lenders here is even higher than in the factoring scenario, since they are funding materials that are not ready for sale and have not been delivered to the end client – so interest rates are higher, too.

Not only is P.O. financing more expensive than factoring, it actually always involves a factoring component. The P.O. funder wants to be paid back as soon as your product is delivered to the end customer. So you need to have a factoring line available to pay off the P.O. lender, and provide you working capital for operations.

With this dual financing program, your margins need to be very good or there will be little or no remaining profit in the order after the P.O. lender and factor take their cut. Getting a P.O. loan is basically a desperation move used to preserve or establish an important client relationship or to get in the door with a large retailer. But if you don't have the money you need to fill a big order, P.O. lending can really be a lifesaver.

16.Import/export loan. For the capital you need to expand your business into foreign markets, there are specialized import/export loans. Most of these are backed by the **Export-Import Bank of the United States**.

If you are exporting, be sure to use the resources available through the U.S. Dept. of Commerce, which arranges introductions with possible buyers and organizes trade missions abroad. The recently passed **National Export Initiative** earmarks new funding for helping startups and small companies not yet selling overseas.



Think of this as P.O. financing but across borders. Import/Export financing through non-bank lenders is essentially a P.O. loan that involves a product that crosses into another country.

Bonus Idea

Gift-funding sites. Crowdfunding sites such as [Peerbackers](#) and [Kickstarter](#) work on a similar crowdsourcing model to the peer-loan sites, but with a twist: The **money you raise is a gift**, not a loan. Most companies end up rewarding donors with discounted merchandise, so this method is not without cost...but still. The bottom line here is you end up with no loan payments to make.



There are some limitations to this plan. For instance, on Kickstarter you cannot raise money for general working capital needs, only for a specific project. Artsy businesses such as graphic design, filmmaking, and apparel tend to be the most successful on gift sites. While Peerbackers is a crowdfunding site dedicated to entrepreneurs and startups, it still focuses on total funding amounts less than \$35,000 and the average raise is less than \$10,000.

Additional Information



If you've got questions about the best way to borrow money for your business, [Hawkeye Management](#), is here to help. Feel free to use us as a resource to help you obtain the capital you need. You can call us anytime for a free, no-obligation consultation at [1-888-783-1503](tel:1-888-783-1503) or just visit our website at www.hawkeyemgmt.com. Follow me on Twitter [@tomgazaway](https://twitter.com/tomgazaway)

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