

Business Financing and Funding Alternatives

Appropriate structuring of the financing arrangements of any business will be the key to the business's survival. Not only is the amount of funding important, but also the nature and the structure of the funding arrangements. In this article, we will discuss financing options and funding alternatives available to businesses.

Traditional business funding is usually acquired through bank financing that is supported by the assets of the business and by the principals of the business through guarantees and security. However, a number of alternative forms of financing are available to the business person, including family, friends and self; third-party equity; government; lending transactions and cash stream funding.

Family, friends and self is the initial source for most start-up businesses. Generally, all that is needed is money available and the confidence of family and friends who contribute. What is often overlooked is how to protect these funds from future problems. These funds are often not secured against assets of the company, meaning if the business encounters financial difficulties, this money may not be recoverable.

There are a number of sources of third-party equity. Venture capital companies will often acquire an interest at an early-stage of a company. A venture capitalist will usually require some assurance that the business has some unique aspect which will help it to succeed. Merchant bank arrangements are another form of third-party equity that generally require a more mature company, and again will require something unique which will probably lead the company to be successful. The merchant bank will generally wish to have some control over the operation of the business and will require an arrangement that provides an exit for the merchant bank. Such investment agreements usually run for three to five year term.

There are some sources of funding through government programs. These programs are generally oriented toward employment programs and will generally require a more established business that is in the process of expanding its employment base. Types of government funding vary and may include equity-type funding, grants, loan arrangements and secured loan arrangements.

Lending transactions for a start-up company usually require some form of asset-based security, often based on the assets of the company. Term lending is one form of lending, often provided by insurance companies, which is based upon security of assets, including real estate, machinery and equipment. Term lending is generally for a fixed term in the range of three to twenty-five years. Lending will require proof of available operating funds, reasonable cash flow, and security value in the assets lent against.

Cash stream funding includes methods that free up cash flow for a business. Leasing is an alternative method of financing the use or purchase of real estate, machinery, equipment and intellectual property. Leasing is a financing alternative to a business because it frees

up money which would otherwise be required to purchase property of assets, by permitting payment to be made on a monthly basis. Leases can also be structured with a purchase component, which will ultimately result in ownership of the property or asset.

Many alternative sources of funding will require certain information before investing in a business, including an understanding of the relationship between profit and the output that is required to achieve that profit (for example, employees and equipment), a risk profile of the business including the relationship of debt to equity, a comparison of the business' performance with industry standards, cash flow for a one-to-two year time frame and updated seasonal performance reports. Preparation of a three-to-five year business plan, which outlines the structure of the business arrangements as well as the financial needs of the company will enable a new business owner to make appropriate funding decisions while providing necessary information to potential sources of funding.

A new business owner should obtain legal advice when creating a business plan as well as when considering what type of funding to obtain and what type of security to give to different sources of funding.

In the following issue, we will explore real estate considerations when starting up a new business.

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