Facing the Challenge of Financing a SMALL BUSINESS START-UP

By Bruce Hurta

You have a dream for a small business start-up. You finally have a business plan which you think will work for you. You even have some savings for seed capital in the business, but it is not enough to keep you going until you start making a profit and the business pays for its continued growth. Where do you go to source more funds for this project?

Financing for Your Small Business Start-up

If your ideas are sound, and if the business plan has enough research and facts included to make it believable, you are off to a good start. All you need to do is find an investor who understands and believes in your business plan to buy into it. The problem, however, is that investors want a share of the business which you feel may not be proportionate with their investment. Can you borrow the money? The answer is "yes" if you locate a small business lender who finds your plans in line with five basic categories.

Investment

The business lender will first look at the amount of your investment in the business compared to what you expect from the lender. That lender is determining if your level of investment is appropriate for the lender to invest their funds and assume the risk of success with you. Unfortunately, "adequate capital" can be defined differently by business lenders with varying expertise and appetites for risk.

The small business loan approval process is a mixture of science and art. No lender can absolutely predict the future. We can only evaluate the five measures of business success in relation to one another and based upon our experience and statistics with business failures and loan defaults. The equity a borrower has in the business is their "skin in the game," and the amount must be reasonable in relation to the other four underwriting criteria.

Future Cash Flow

The second predictor of business loan repayment ability will be an analysis of the future cash flow of the business. This is where the start-up business has a large disadvantage compared to an existing business with a track record. The small business start-up owner must prepare a business plan and financial projections to predict the flow of cash of their business. They must predict the cash needs prior to breaking even with a profit, and the small business lender must believe those predictions have a high likelihood of manifesting. The business plan, including the assumptions detailed with financial projections, gives the lender a view into the borrower's industry experience, market research, analysis of the business' competition, and methods for marketing and retaining customers.

Management Background

The third criterion which the lender reviews is the management background, including educational experience and industry business experience, which the applicant brings to the table. An actual track record of managing a similar or related business is the best evidence of management ability for a small business start-up. One indicator can be the education and training the borrower has received to prepare for business ownership. Another way of strengthening the management experience component is adding partners, shareholders, or other owners with sufficient experience to assist with management, and who are willing to take personal liability on the loan with the other primary owner(s).

In the cases of start-up franchise businesses, the lender will evaluate the past performance of other franchisees in that franchise. If the franchise has a high percentage of successful franchisees, the lender may deduce that the franchiser offers effective management support to their franchisees such that the lender does not feel the need for as strong a pedigree from a borrower affiliating with that franchise.

Credit History

The fourth consideration of the lender is the small business start-up owner's personal credit history. If the owner of the new business has a steady history of clean personal credit, they are much more likely to do whatever it takes to preserve that good record. This is merely a statistical fact.

Collateral

Finally, the lender will consider the collateral offered for the loan. Many small business start-ups are begun without significant assets that can be offered for collateral. If the borrower has no available personal assets to pledge for collateral, this makes the loan application process even more challenging. Conventional bank lenders often have policies limiting loans to businesses that are at least two years old. They would rather see the new business owner use a personal loan, such as a home equity line of credit, to finance their small business start-up because the borrower's home can be used for collateral.

With all these challenges facing the new small business start-up, SBA government-guaranteed financing offers a much needed alternative to conventional bank financing. SBA loans are still not easy to qualify for, but are more easily attainable. They do not require collateral, but the lack of collateral will increase the reliance on the other four underwriting criteria described in this article. Bringing the lender a well-thought-out business plan, with the experience commensurate for success, the small business owner is much more likely to attain the financing they need. They still need a significant amount of their own cash (skin in the game) to entice the lender to invest with them, but most good small business start-ups will find the capital needed to satisfy the lender from their savings or by joining with other investors in the project to adequately fund the new business in relation to the debt being contemplated with an SBA loan. **N**

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