ebook by ASBTDC

Funding Your Small Business

Loans & Other Options

ASBTDC

ARKANSAS SMALL BUSINESS AND
TECHNOLOGY DEVELOPMENT CENTER

Contents

Introduction

While boostrapping a business with your own savings is common, most small business owners will seek outside funding at some point. With the diverse alternatives available, how do you decide which option is the best fit for your business?

In this e-book you will find descriptions of 12 types of small business financing, along with an estimate of the time and the cost required to obtain them. The hourglass and dollar sign icons allow you to quickly compare the options.

As you investigate and evaluate the various funding possibilities, make sure you keep in mind the financial status of your business, your specific needs, and your timetable.

The Arkansas Small Business and Technology Development Center can help. ASBTDC works with hundreds of current and prospective business owners each year, helping clients determine how much money they need and which type of financing best fits those needs. In addition, as business owners seek financing, ASBTDC helps with business plans, loan proposals, and applications.

If you want to start or buy a business or are already in business, this e-book is for you!

- Business start
- Business purchase
- Existing business

What Type of Funding Do You Need?

As you investigate the various funding possibilities for your small business, consider these questions:

How much do you need? The amount of money you need will influence the type of funding you seek. Developing cash flow projections can help you determine the amount of capital you need to start, operate, or expand your business.

Realize you are unlikely to obtain 100% financing for your project from a lender. Lenders expect the borrower to share some of the risk.

What is your time frame? Often, the process of applying for business financing is more time consuming than for a personal loan or mortgage. Plan ahead and allow adequate time. If you need money quickly, expect to pay a higher interest rate. Waiting until the last minute when you are in a bind can result in a denial.

What is your credit score? Small business loan programs take personal credit into consideration. Individuals with poor credit history will pay more for a loan. Those with good credit will typically get a better interest rate and will have more options.

Some people may be unable to obtain a loan from any source due to personal credit problems. If your credit is poor, the first step is to re-establish good credit.

Do you have collateral to offer to secure a loan? Some loans are unsecured while others require collateral for the loan. Unsecured loans often have a higher interest rate. In general, the larger the loan amount, the more likely collateral will be required.

Does the business show repayment ability? Many lenders require a business to demonstrate repayment ability – particularly for larger loan amounts. A wise business owner will develop monthly financial projections to verify repayment ability, even if not required to do so by the lender as part of the application package. If the business cannot repay the loan, obtaining a loan causes more problems than it solves.

Is the business a good investment? To entice lenders or investors to support your venture, you must be able to demonstrate that the business has the potential to provide expected returns.

Are your expectations reasonable? Business owners expecting free or cheap money without having to meet certain credit standards or inject any of their own cash are bound for disappointment. Not every applicant will be able to get a business loan. Even creditworthy business owners need to be prepared for the time and documentation required to get financing.

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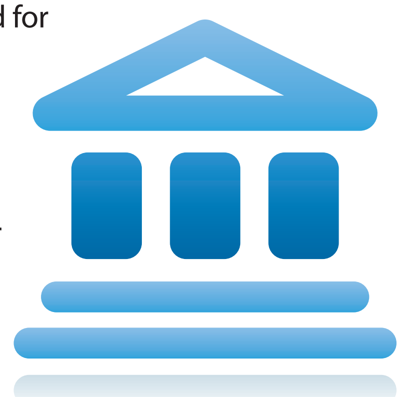
Loans

- TRADITIONAL BANK LOANS
- SMALL BUSINESS ADMINISTRATION LOANS
- PEER-TO-PEER LENDING
- ALTERNATIVE ONLINE LENDERS & BROKERS
- MERCHANT CASH ADVANCES
- FACTORING
- MICROLOANS
- STATE & LOCAL PROGRAMS

Traditional Bank Loans

Banks offer several types of commercial loans, including lines of credit, term loans, and balloon notes. The terms of the loan are influenced by several factors, including the amount of the loan, the intended use of the funds, and the applicant's credit and collateral.

Occasionally, a borrower may be able to obtain an unsecured loan if he or she has great credit and the loan amount is small. For larger loans and for borrowers with satisfactory (but not excellent) credit, banks will likely require some form of collateral for the loan.



Typically, lenders will use business assets for collateral to the extent to which they are available. However, the collateral value of many business assets (such as equipment, furniture/fixtures, or inventory) is low, so the bank will look to the business owner for personal assets to serve as collateral for the loan. Specifically, the bank will ask for equity in real estate or cash equivalent investments such as certificates of deposit as collateral.

Lenders commonly require borrowers to offer the equity in their homes as collateral for business loans, and generally are not interested in jewelry, home furnishings, or personal vehicles.

A good place to start when considering applying for a commercial bank loan is to talk with a bank where you already have an account.

Keep in mind that the bank needs information about your business to make a decision on your loan request. Expect to provide the lender with information about existing business debts and documents such as tax returns, current financial statements (business and personal), and your business plan.

TIME: MODERATE

The loan amount, the creditworthiness of the borrower, and the bank's internal processes can all influence the time it takes to obtain a commercial bank loan. At minimum, allow a few weeks.

COST: LOW TO MODERATE

For creditworthy borrowers, commercial bank loans tend to be lower cost than other forms of financing.

SBA Loans

Small Business Administration-guaranteed loans are not direct loans. Instead, SBA loans are provided through participating financial institutions (bank or non-bank lenders). SBA guarantees, or backs, a portion of the loan to the lender. For an SBA loan, both the lender and SBA consider the borrower's collateral, credit, equity, and experience, and the history of the business, when making a determination.

TIME: MODERATE TO LONG

Obtaining an SBA-guaranteed loan can take longer than a traditional bank loan. Depending on which SBA program is used, once the lender submits a finalized application to SBA, the turnaround time is typically 10 days or fewer. However, the time involved with getting to that point should also be considered.

First, a borrower must find a lender interested in the project. Then the lender applies to SBA for the guarantee on behalf of the borrower. Specific documentation is required for an SBA loan, and gathering the required documents can be tedious and time-consuming. Therefore, well-organized borrowers will typically move more quickly through the process.

The lender has paperwork to complete as well before the application goes to SBA. ASBTDC recommends that borrowers allow at least 60 days for SBA 7a and 504 loans. SBA Express may require less time.

Visit sba.gov for details about the various SBA loan programs.

COST: LOW TO MODERATE

The lender sets the interest rate that is charged on an SBA loan, but SBA limits the interest rate that that the lender can charge. On loans over $50,000, the interest rate is 2.25% to 2.75% over prime. The cost is higher on loan amounts under $50,000.

In addition, the SBA charges an upfront guaranty fee. The fee depends on the amount of the loan but typically is in the range of 3% to 3.5% of the guaranteed portion of the loan.

See page 9 for information about SBA microloans.

Peer-to-Peer Lending (P2P)

Peer-to-peer lending (P2P) is a loan where the online platform serves as an intermediary to connect lenders and borrowers and facilitate transactions. Lenders select borrowers based on the loan profile and scoring.

P2P sites are regulated by the Securities and Exchange Commission. Loans are issued by a platform such as Lending Club or Prosper but are funded by supporters of the loan. Loans are to be repaid by the borrower to the platform, which then repays the funder. Often, these loans are small personal loans and are typically unsecured.

This type of lending is not for non-bankable deals. It is for borrowers seeking unsecured loans on a relatively quick timetable. The application is similar to what you would fill out at a bank.

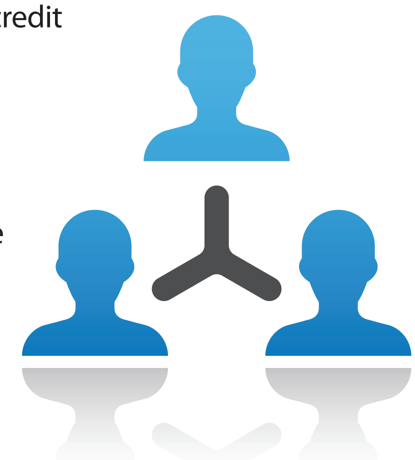
TIME: SHORT

Once you complete your online loan application, your time frame to obtain funding can be short relative to many other forms of financing (if your deal is attractive to lenders). Most sites will only leave the deal posted for two weeks. If your deal is funded prior to the end of the two weeks, you get your money faster.

COST: MODERATE TO HIGH $$$

P2P lending sites typically use the concept of risk versus reward when assigning interest rates. Their scoring is based on the personal credit of the borrower. Generally, a person with better credit would have a lower interest rate and a person with average credit would have a higher rate.

In addition, the lending platform typically charges a fee based on a percentage of the loan amount and/or a percentage of the interest paid on the loan.



Alternative Online Lenders & Brokers

A variety of alternative lenders (sometimes referred to as "innovative lenders") are now operating online. Many of these lenders target the sub-prime market, attracting businesses that cannot get credit through traditional channels. Other online lenders are competing with local lenders for borrowers who are good credit risks.

Online loan brokers try to match prospective borrowers with lenders seeking loans of that type. Many of these loans are short-term loans of less than one year. Some are not actually loans but rather merchant cash advances that take a cut of daily credit card sales as repayment.

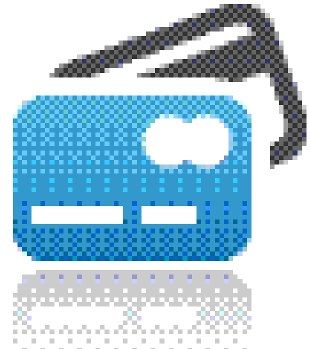
TIME: SHORT TO MODERATE

The length of time will vary based on the process on the website and the attractiveness of the deal.

COST: HIGH

The fee structure and interest rate depends on the site as well as the risk of the project. However, this capital tends to be expensive, especially for customers who are unable to obtain financing through traditional channels. Loan broker sites add an additional fee to those charged by the actual lender.

Merchant Cash Advances



With merchant cash advances, funds are provided to businesses in exchange for a percentage or portion of daily credit card sales until funds are repaid. While this form of capital can be a quicker option than a conventional loan, the cost is typically very high. The business's sales volume is an important consideration for these lenders.

TIME: SHORT TO MODERATE

A merchant cash advance can be obtained in as little as a few days to a week.

COST: HIGH TO VERY HIGH $$$$

When stated in terms of annual interest rate, the cost of a merchant cash advance can be sky high. For example, a loan for six months requiring 25% payment over the amount borrowed is equivalent to a 50% annual interest rate (APR). Be sure to inquire about the estimated APR on any funds advanced to get a clear picture of the actual cost of capital.

Factoring

Factoring is a type of financing in which a business sells accounts receivable for cash at a discount on the face value of the receivables. Essentially, the business sells the receivables at an amount less than the value of the receivables.

The factoring company is repaid upon collection. When the receivables are collected, the funds are repaid to the financing company.

TIME: SHORT

Factoring applications can be approved in as little as a few days.

COST: HIGH $$$

The actual cost of capital with factoring is equivalent to the discount at which you sell the receivables to the factor (the company that purchases the receivables). The amount of this discount is based on the quality and length of the receivables.

Since the cost is not quoted as an interest rate but rather a discount at which receivables are purchased, it is often hard to determine the actual cost and compare factoring's cost to other funding alternatives.

Microloans

Microloans are business loans for smaller amounts than typical commercial loans. A good rule-of-thumb is less than $50,000. Many are much smaller amounts.

Some microlenders, like Kiva, are non-profit organizations operating worldwide.

However, Small Business Administration microloans are provided through a local intermediary, and the decision on the loan is made at the local level. These intermediaries are local community-based organizations that have their own lending and credit requirements.

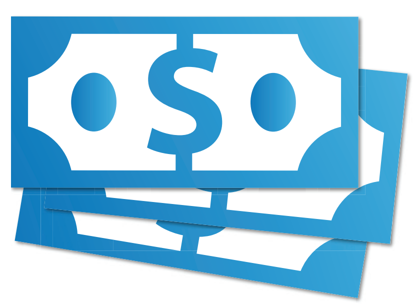
Typically, some collateral is required, and the business owner must personally guarantee the loan. The allowable interest rate on a microloan is higher than on a regular SBA loan. The creditworthiness of the project is considered in the loan determination.

TIME: MODERATE TO LONG

Since SBA microloans are provided through a local microlender, the time it takes to move through the financing process will depend on that organization's processes and work load.

COST: MODERATE TO HIGH

SBA's allowable interest rate on microloans is higher than the allowable rate on loans over $50,000. For specific cost and credit requirements, contact your local SBA microlender.



State & Local Programs

Some state and local economic development organizations offer their own loan programs for businesses. Examples:

AEDC'S MINORITY & WOMEN-OWNED BUSINESS LOAN MOBILIZATION PROGRAM

Through this loan guarantee program, a business owner borrows funds from a local lender, and the program provides a guarantee on those funds to the lender in order to facilitate loans to minority-owned or women-owned businesses. For more information, contact the Arkansas Economic Development Commission, Minority and Women-Owned Business Division.

arkansasedc.com

DFA DISADVANTAGED BUSINESS ENTERPRISE/ SMALL BUSINESS LOAN GUARANTY PROGRAM

The Arkansas Department of Finance and Administration has a loan guaranty program for small and disadvantaged businesses. Funds must come from a participating lender.

adfa.arkansas.gov/program/arkansas-small-business-guaranty

PLANNING AND DEVELOPMENT DISTRICTS

Planning and development districts serve regions throughout the state, and some districts have loan programs for small businesses in their community. For more information, contact the planning and development district that serves your area.

In addition to the loan programs above, some state agencies and organizations have some seed funding for innovation and technology-based ventures. One example:

ARKANSAS RISK CAPITAL MATCHING FUND

The Arkansas Risk Capital Matching Fund, managed by the Arkansas Development Finance Authority, supports technology-based enterprises in the early stages of development.

adfa.arkansas.gov/program/arkansas-risk-capital-matching-fund

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Other Types of Funding

- CROWDFUNDING
- ANGEL INVESTMENT
- VENTURE CAPITAL
- GRANTS

Crowdfunding

There are two basic types of crowdfunding: rewards-based (or donation) crowdfunding and equity crowdfunding.

Rewards-Based – Rewards-based crowdfunding is where the funder receives something in exchange for his/her donation. The reward could be an item like a T-shirt or coffee mug or pre-purchase of a product. A variety of websites offer rewards-based crowdfunding, including Kickstarter, GoFundMe, and Indiegogo. With this form of crowdfunding, the business owner does not have to give up any equity and the money raised does not have to be repaid.

Rewards-based crowdfunding works best when you have a compelling story and the ability to market the pitch. To start a crowdfunding campaign on the right foot, most experts recommend that business owners pre-raise about a third of the funding target before the campaign begins.

Equity – Through equity crowdfunding, early-stage ventures choose to raise funds by offering shares of the company in exchange for investment by multiple people. Projects must be administered through a firm registered with the SEC.

TIME: MODERATE TO LONG

The length of time involved in obtaining crowdfunding is directly related to the length of the campaign, which typically ranges from 30 to 60 days.

COST: LOW TO MODERATE

Most reward-based crowdfunding sites keep a percentage of the money raised. This often ranges from 3-10% but can be higher. Be sure to compare costs and fees for each site when selecting a platform. In addition, you should also consider the costs of the reward or product (for pre-purchases) that donors receive for contributing to your campaign. The cost structure for equity-based crowdfunding would differ.

Venture Capital

Venture capital firms make investments in companies that are positioned for high growth.

VC firms will do significant due diligence to determine whether or not to invest in a company and are looking for a clear exit strategy that will provide a high rate of return. For a business to be attractive to a venture capital firm, the company must have some sort of unique competitive advantage or high-value technology (or both) along with a strong management team.

TIME: VERY LONG

Since venture capitalists are often investing sums in the millions, they take their time reviewing and screening prospects, on average two to six months.

COST: MODERATE TO HIGH

VCs often will ask for a 10-40% ownership stake, and company founders likely will give up control of the company's direction and governance.

Angel Investment

Angel investors are high net worth individuals who invest their own money in business opportunities (generally, early-stage businesses).

Some are part of an organized angel group or network, while others or not. Angels may target businesses in a specific industry or geographic area that has personal appeal for them.

Business owners typically find individual angel investors through their own personal contacts. Alternatively, organized angel investor groups can be found online.

Angel investment is often not just a one-time injection, as a company may receive multiple rounds of angel funding over several months and years. Angel investors will expect a sound business strategy that will help them obtain a good return on their investment.

TIME: MODERATE

Angels can act quickly or, in the case of organized groups, more deliberately, so timing will vary. Most angel groups have multi-step review processes.

COST: MODERATE TO HIGH

Angels will expect a stake in the company. The earlier they invest and the more capital they invest, the larger their equity.

Grants

Small business grants are scarce. Neither the ASBTDC nor SBA provides grant funding to small businesses. To our knowledge, there is no free money available for starting a small business.

Major brands, including Intuit and Microsoft, sponsor contests for small businesses from time to time, offering cash and other prizes.

Existing small businesses in a specific industry or with a certain focus may be eligible for government grants, such as through the federal **Small Business Innovation Research and Small Business Technology Transfer (SBIR/STTR)** programs that support research and development by innovation-based companies. However, such programs are very narrow in scope.

Most grants are for non-profit organizations or educational institutions. Generally, small business owners have to rely on loans or personal funds.

Checklist

- [ ] **DEVELOP CASH FLOW PROJECTIONS** — Projecting your monthly cash flow will help you determine the amount of money you need to obtain.

- [ ] **CHECK YOUR CREDIT** — Personal credit is a factor in the funding decision for small business financing and loans. If your credit is poor but you still want to pursue the project, your next step is to focus on repairing your personal credit.

- [ ] **SET YOUR TIMELINE** — The time it takes to obtain funds varies based on the type of funding you pursue, the amount of funds you seek, and the creditworthiness of the project. In general, larger projects where the borrower's credit is marginal often take more time.

- [ ] **DETERMINE YOUR BORROWING CAPACITY** — Most loan programs consider common criteria: credit, collateral, equity, and repayment ability.
  Do you have good credit?
  Do you have collateral to secure the loan?
  Can you demonstrate that you have the ability to repay the loan?
  Do you have adequate equity in business or cash to contribute towards the project?

- [ ] **SELECT THE APPROPRIATE FUNDING SOURCE FOR YOUR BUSINESS** — Consider the cost of capital, as well as repayment terms and eligibility and application requirements, as you select the funding source that fits your needs and timeline. Have a Plan B if you first option doesn't work out.

- [ ] **GATHER DOCUMENTATION** — Funding sources differ in the amount of documentation and information required to apply. You may have to provide business tax returns, a business plan, a personal financial statement, and resumé.

- [ ] **SUBMIT COMPLETE APPLICATION** — When applying for a loan or other funding, make sure you include all required documentation. An incomplete application can lengthen the time required to obtain an answer or can result in being turned down.

- [ ] **WAIT FOR AN ANSWER** — Do not assume a project will be funded. Wait to obtain a formal answer from the funding source before signing agreements (such as leases) or committing to purchases.

Call On ASBTDC

Your local Arkansas Small Business and Technology Development Center can assist you as you seek to obtain funding and prepare a funding request.

ASBTDC staff can answer questions, provide guidance and direction, review business plans and funding proposals, and aid in the preparation of loan application packages. We also offer helpful seminars and webinars.

Please note, ASBTDC does not give business loans or grants, nor do we have any input in lending decisions. We cannot influence a funding source's decision about your project or negotiate on your behalf when you apply for a business loan.

CONSULTING

Get one-to-one professional consulting at no cost. Our confidential guidance can be tailored to your specific venture. Help available includes review of business plans and strategies, guidance in starting new businesses, preparation of loan requests, financial analysis and budget development, and advice on operating challenges in existing businesses.

MARKET RESEARCH

Better understand who your customers are, what motivates their purchasing decisions, and who your competition is. Utilizing an array of tools and resources, ASBTDC market research helps clients make sound business decisions and solidify capital funding requests. Market research services are offered free of charge to ASBTDC's small business clients.

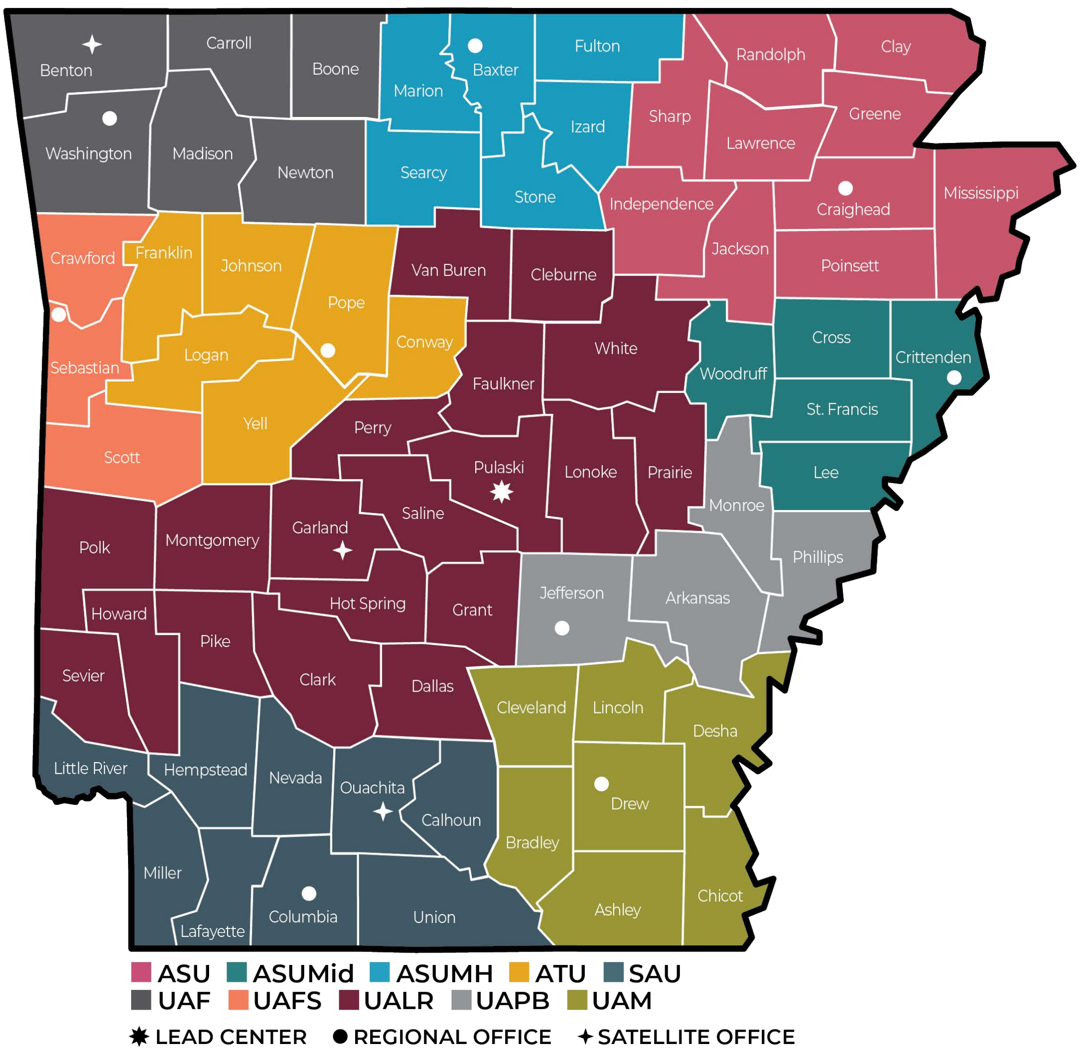
PROGRAMS

Expand your expertise with ASBTDC's affordable small business programs and events! We offer live seminars in locations throughout the state as well as webinars and other online learning opportunities. Instructors and facilitators include ASBTDC staff and business professionals such as accountants, bankers, attorneys, marketing professionals, small business owners, and others.

See our video "Qualifying for a Business Loan" at **asbtdc.org/services/financing-your-business**

Where to Find Us

The ASBTDC is a higher-education-based economic development program, so our centers are all affiliated with universities and colleges. Through our offices around the state, we help small business clients with every aspect of business creation, management, and operation. Find contact information for your local ASBTDC at **asbtdc.org/contact**.



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