Business Financing: From Credit Cards to Venture Capital

By Penny Hulbert

Ask successful entrepreneurs about business financing, and it's likely they will tell some interesting stories about how they got the business off the ground. The stories aren't always pretty, but what's important is they got the job done.

It's always been tough to get financing, particularly for a new business, and it's even more challenging now. But even though the news may seem full of gloom and doom, that doesn't mean business financing is impossible in today's economic climate. As is often the case, what's important is to understand the options, prepare the company and make the right contacts.

Where to start

Businesses in start-up mode have limited options and most typically rely on "bootstrapping," using their personal lines of credit, credit card debt and savings. Once these options are exhausted, business owners turn to friends and family for help.

One of the most challenging financing gaps has always been that of early stage or angel investing, and this has become even more difficult during the economic downturn. Angel investors tend to be very particular and risk intolerant, with a rather short investment time frame. They are most comfortable investing in industries they understand because they are better able to evaluate the potential risk.

For technology start-ups in Florida, this is not very good news, as many angel investors have retired to Florida after a career in manufacturing, retail or service industries. Although angel networks tend to be somewhat secretive, the Florida Venture Forum holds an annual early stage conference, giving entrepreneurs the chance to mix and mingle with early stage investors and – for a chosen few – the opportunity to present their case for funding.

While start-ups are often funded with equity, there are opportunities for established businesses with consistent cash flow for debt financing from a bank. This is where a pre-existing relationship with a banker comes into play – it's certainly not the time to go shopping for a new bank! Realistic projections and solid financial statements make for a strong presentation.

Many companies make the mistake of pinning their hopes on catching the "brass ring" of venture capital or private equity financing. Although many venture capital and private equity firms are well funded (in large part because they've been sitting on the sidelines and/or raising new funds), this is still an impossible dream for most companies.

Private equity funding may be an option for businesses with $2 million or more in annual cash flow, but the private equity group may want to acquire all or most of the business, or provide investment capital that gives the owner a desired level of liquidity while he/she still maintains a majority ownership position. Private equity groups often seek investments that will yield two to five times invested capital within a three- to seven-year investment time horizon. Investments range from as little as $500,000 to millions of dollars.

Venture capitalists take an active role with companies in which they invest, usually as members of the board of directors. Their goal is an annual return of greater than 30 percent and a total return of up to 20 times their investment. Funds may invest up to $8 million in a single business during a three- to five-year window.

Having what it takes

Knowing what each financing source is looking for improves the chances of success. Following are additional specifics:

- Angel investors want to see a solid business plan with realistic revenue projections and valuation expectations. Demonstration of market knowledge is important in terms of understanding the competition, the market potential and market growth prospects. The entrepreneur should have a financial stake in the business and a scalable business model and be well differentiated in the market.
- Banks look for the same factors, but also focus on character, capacity to repay, collateral, net worth/liquidity and general economic, industry-specific and business-specific conditions. How the loan will be repaid is critical, as is the back-up plan that will be used if something happens to the primary repayment source.
- Private equity groups and venture capitalists invest in businesses with a solid business plan, strong growth potential in an industry the group likes, a successful and experienced management team, significant barriers to entry, recurring and sustainable revenues, a lack of insurmountable competition and little or no customer concentration.

Although this may not be the best of times, there are still businesses being funded. Understanding what the financing sources expect, listening to business advisors such as those available through STAR TEC and then presenting a compelling case can make the difference between crossing the finish line and being an also-ran.

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