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Never say 'never' when it comes to business financing

It helps to understand all the various sources

If conventional wisdom always held true, there would be little innovation and much less business growth.

Take the current conventional wisdom about business financing — "There's no money being invested. ... No banks are lending. ... Private equity sources have dried up."

Like most conventional wisdom, there are certainly elements of truth to this. But that doesn't mean business financing is unattainable in today's economic climate.

Guest Column
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UNDERSTANDING THE OPTIONS

For a startup business, personal funds are the most common alternative, whether in the form of home equity lines of credit, credit card debt or savings. Once the personal credit has been exhausted, friends and family form the next tier of cheap sources of funds.

Early stage or angel investing has become increasingly selective, particularly in Florida.

Angels tend to invest in industries they understand, as they are better able to evaluate the potential risk. And while they tend to be overly optimistic during positive market times, they may be overly pessimistic during periods such as we are experiencing now.

While startups are typically funded with equity, established businesses with consistent cash flow may be able to tap into debt financing at their local banks.

A number of community and regional banks in the Tampa Bay area have said they are still "open for business" and eager to work with businesses for their credit needs — a scenario quite different from that expressed by many national and super-regional banks. However, many of the non-traditional sources, such as asset-based lenders and leasing companies, have nearly disappeared from the current financing scene.

Private equity financing for privately held firms may be an option for businesses with $2 million or more in annual EBITDA, or cash flow. 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 hundreds of millions of dollars.

GETTING TO THE HEAD OF THE LINE

Understanding which financing source is appropriate for the business's life cycle stage, history, industry and growth potential is important.

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Following are pointers for the various financing sources discussed above:

• Angel investors.

These criteria also apply to most of the other financing sources, except possibly your Aunt Mildred. Angel investors are looking for a well-developed business plan with realistic revenue projections and valuation expectations.

A thorough understanding of the market is helpful.

Are there numerous competitors? How big is this market, and is it growing? Are there any other forces contributing to the viability of the industry?

In addition, angel investors often invest in market sectors in which they had direct business experience and look for entrepreneurs with skin in the game, a scalable plan, clear vision and market differentiation — all of which will lead to a lower level of risk and a greater chance for the business to succeed.

• Banks.

In addition to the business plan described above, banks look for the "Five C's" of Character, Capacity (ability to repay), Collateral, Capital (net worth, liquidity) and Condition (general economic, industry-specific and business-specific conditions).

Being able to answer how the loan will be repaid is essential.

Will it come from identifiable profits? The collection of accounts receivable?

If something happens to the primary repayment source, what is the back-up plan?

Will the secondary repayment source come from the sale of an asset? Or monies from the guarantor?

• Private equity groups.

Preferred opportunities include growing businesses in an industry the group likes; significant barriers to entry; a good management team; recurring, sustainable revenues; no insurmountable competition, and little or no customer concentration. Private equity groups also will be interested in a solid business plan, just like the other funding sources.

It's been said that the best businesses can always be funded. Understanding the options and working with the appropriate business advisers can do a lot to put a good business into that category.

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