SMALL BUSINESS FINANCING OPTIONS

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Most small business failures occur because the company lacked working capital, not because it didn't have a good product or service. Unfortunately, this problem is currently magnified for many small businesses dealing with tough economic times. They still need to hire new people and buy inventory in order to grow. In many instances they need to borrow money to meet these requirements, but they may not qualify for a bank loan. As a result, many small businesses are turning to alternative sources for financing. Here are several options to consider:

1) **Government Financing**: When formal bank financing is unavailable, federal, state and local governments can be a good alternative. This is especially true if your company falls into one of several supported categories of small businesses: women- and minority-owned businesses or those started in special business development or "empowerment" zones. The first place to go to find out what government financing might be available to you is the Small Business Administration, which acts both as a funder and as a clearinghouse of information about sources of financing for small businesses. Also your company should register with the local Small Business Development Center, which can be an excellent resource for funding opportunities, as well as general information that may be helpful in operating your business.

2) **Accounts Receivable (A/R) Financing**: A/R financing is somewhat similar to a bank loan, as a business submits all of its invoices to a finance company, which establishes a borrowing base against which the company can borrow money. The qualified receivables serve as collateral for the loan. The finance company will charge a collateral management fee (usually 1 to 2 percent of the outstanding amount) and assess interest on the amount of money borrowed. While this is a common alternative financing arrangement, the fees and interest can add up, so you will want to make sure that your business can absorb the cost prior to agreeing to this type of financing.

3) **Asset-Based Lending**: These loans, often in the form of lines of credit, are based on a percentage of the value of a company's assets. This is similar to accounts receiveable financing except that the loan is secured by business assets other than accounts receivable, such as equipment, real estate and inventory. Interest is charged on the balance of money borrowed and certain fees are typically assessed in setting up the line of credit, so you will want to make sure that the company can absorb those costs.

4) **Merchant Cash Advances**: This option provides capital in exchange for a share of future credit or debit card sales. This is a type of financing for small businesses

where a large number of customers pay with debit or credit cards, such as retailers and restaurants. These lenders usually charge between 8%-10% of the gross sales against the advance, so if you go this route, you will need to make sure that your company can absorb such a charge.

5) **Leasing Equipment:** Equipment leasing is a financing option and, depending on how a lease is structured, there may be advantages to leasing over financing equipment purchases through a bank or paying cash for the equipment. For example, lease can be structured so as to provide tax and financial advantages. A lease may also be structured so that payments match a company's cash flow or business ramp-up expenses. Plus, leases typically only require minimal payments up front, such as the first payment, so there is not a lot of initial expense in leasing. Moreover, during the early part of the lease term, rent expense is less than what the depreciation and interest expense would be for a loan. Leasing also offers advantages over paying cash for equipment, since business revenues are created through the use of equipment and not through owning the equipment.

   But, there are certain questions that should be answered before you choose a lease option. First, the lease document needs to be clear as to what happens during the beginning and end of the lease. First, is the leasing company providing internal financing for the lease, or will the lease be funded through at third party finance company? At the end of the lease, does your company own the equipment, or is there a buyout? If there is a buyout, how is it defined? If the lease does not have a definitive term, what are your company's options at the end of the lease term, are there options to purchase the equipment and what happens if you don't exercise any options? Does this put your company in a situation where you could have obligations that don't make business sense? Once the lease is in place, if there is a repair, service or billing issue, what steps do you have to take to get the issue resolved? Also, what happens if your company wants to upgrade the leased equipment before the end of the lease, can you do that without an additional fee?

6) **Factoring**: A factoring company buys a business' accounts receivable. They will provide the company with a discounted amount of cash immediately and then they handle collection of amounts due from customers. There are two general types of factoring: with recourse and without recourse. With recourse means that if the company's accounts receivables are not paid by a certain time they will give they will give them back to the company and ask for a refund of the money advances. Without recourse means that the business sells the accounts receivable to the factoring company and they take sole responsibility for collection of amounts due.

   The downside of this approach is that the factoring company will discount (pay less than the face value) of the accounts receivable, so your company will be receiving immediate cash but the cost tends to be very high, so you will first need to examine whether the business' profit margin can absorb the discount and interest burden, which could be 1.5% to 5%. In case you go for a non-recourse arrangement with the factoring company, then you will need to find out how effective the factoring company's collection staff is and consider the impact of them communicating with

your customers. You will also need to tell your customers of the arrangement and some of them might not be comfortable with it, so the company could lose customers in this process. Plus, a factoring company might not be as accommodating as the company is and their collection staff could be very aggressive while pursuing payments, which could create issues in your relationships with your customers.

Although factoring carries the risk of affecting your customer relationships and tends to be more expensive than traditional bank loans, if your company is in danger of running out of cash while you wait to get paid by customers and your company does not qualify for a bank loan or line of credit, then the only other alternative to keep things afloat could be bankruptcy. As a result, factoring should be kept in mind as a financing option of last resort.

7) **Private Placement Loan:** This type of loan is becoming more common, especially with the very low interest rates currently available for traditional savings accounts. It entails borrowing money from unrelated individuals (non-family) at set terms. This is a small niche of the lending market, but it is growing as investors look for ways to increase the returns on their available cash.

Finally, keep in mind that alternative financing options are usually considered to be transitional sources of financing during a time when the business does not qualify for traditional bank financing. After a certain period of time, typically 12-24 months, you should be able to establish a track record with your financial statement so that your company can qualify for traditional bank financing, which in many instances is less expensive than the alternative financing options discussed above.