



Small Business Financing Options—Despite the Credit Crunch

By Tracy Eden

There's no question that the financial crisis and ensuing credit crunch have made it more difficult than ever to secure small business financing and raise capital. This is especially true for fast-growth companies, which tend to consume more resources in order to feed their growth. If they aren't careful, they can literally grow themselves right out of business.

Amidst all the gloom and doom, however, it's important to keep one thing in mind: There are still options available for small business financing. It's simply a matter of knowing where to look and how to prepare.

Where to Look

There are three main sources you can turn to for business financing:

Commercial Banks—These are the first source most owners think of when they think about small business financing. Banks loan money that must be repaid with interest and usually secured by collateral pledged by the business in case it can't repay the loan.

On the positive side, debt is relatively inexpensive, especially in today's low-interest-rate environment. Community banks are often a good place for small businesses to start their search for financing today, since they are generally in better financial condition than big banks. If you do visit a big bank, be sure to talk to someone in the area of the bank that focuses on small business lending.

Keep in mind that it takes more diligence and transparency on the part of small businesses in order to maintain a lending relationship in today's credit environment. Most banks have expanded their reporting and recordkeeping requirements considerably and are looking more closely at collateral to make sure businesses are capable of repaying the amount of money requested.

Venture Capital Companies—Unlike banks, which loan money and are paid interest, venture capital companies are investors who receive shares of ownership in the companies they invest in. This type of financing is known as equity financing. Private equity firms and angel investors are specialized types of venture capital companies.

While equity financing does not have to be repaid like a bank loan, it can end up costing much more in the long run. Why? Because each share of ownership you give to a venture capital company in exchange for financing is an ownership share with an unknown future value that's no longer yours. Also, venture capital companies sometimes place restrictive terms and conditions on financing, and they expect a very high rate of return on their investments.

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Commercial Finance Companies—These non-traditional money lenders provide a specialized type of small business financing known as asset-based lending (or ABL). There are two primary types of ABL: factoring and accounts receivable (A/R) financing.

With factoring, companies sell their outstanding receivables to the finance company at a discount of usually between 2-5%. So if you sold a \$10,000 receivable to a factor, for example, you might receive between \$9,500-\$9,800. The benefit is that you would receive this cash right away, instead of waiting 30, 60 or 90 days (or longer). Factoring companies also perform credit checks on customers and analyze credit reports to uncover bad risks and set appropriate credit limits.

With A/R financing, you would borrow money from the finance company and use your accounts receivable as collateral. Companies that want to borrow in this way should be able to demonstrate strong financial reporting capabilities and a diverse customer base without a high concentration of sales to any one customer.

How to Prepare

Regardless of which type of small business financing you decide to pursue, your preparation before you approach a potential lender or investor will be critical to your success. Banks, in particular, are taking a much more critical look at small business loan applications than many did in the past. They are requesting more background from potential borrowers in the way of tax returns (both business and personal), financial statements and business plans.

Lenders are focusing on what are sometimes referred to as the five Cs of credit:

- **Character**—Does the company have a strong reputation in its community and industry?
- **Capital**—Lenders usually like to see that owners have invested some of their personal money in the business, or that they have some of their own “skin in the game.”
- **Capacity**—Financial ratios help lenders determine how much debt a company should be able to take on without stressing the finances.
- **Collateral**—This is a secondary source of repayment in case a borrower defaults on the loan. Most lenders prefer collateral that is relatively easy to convert to cash, especially equipment and real estate.
- **Conditions**—Conditions in the borrower’s industry and the overall economy in general will play a big factor in a lender’s decisions.

Before you meet with any type of lender or investor, be prepared to explain to them specifically why you believe you need financing or capital, as well as how much capital you need and when and how you will pay it back (if a loan) or what kind of return on investment a venture capital company can expect. Also be prepared to discuss specifically what the money will be used for and what kind of collateral you are prepared to pledge to support the loan, as well as your sources of repayment and what measures you will take to ensure repayment if your finances get tight.

You should also ensure that your financial statements and records are current and that your internal control systems are adequate for handling the level of accounting and bookkeeping lenders and investors expect.

Tracy Eden is the National Marketing Director for Commercial Finance Group (CFG), which has offices throughout the U.S. CFG provides creative financing solutions to small and medium-sized businesses that may not qualify for traditional financing. Further information on the company and their services offered can be found at <http://www.CFGroup.net>. Tracy’s direct email is tdeden@cfgroup.net