



Choosing the Right Source of Funding

Advice from CPAs

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Choosing the Right Source of Funding

Whether you're starting a business or expanding your present company, adequate capital is essential. Luckily, in the current economic environment, many sources of funding may be more favorable than turning to the traditional bank. In fact, the right sources of funding could mark the difference between success and failure for your company. As you make your way through the funding process, keep in mind that your CPA, as your professional business adviser, can be an important ally in evaluating all the available options and helping you choose the one that best meets your needs.

Key Sources of Business Funding

Banks/Credit Unions — Local financial institutions are a major source of small business financing. If you need a short-term loan, a single-purpose loan for machinery or equipment, or a seasonal line of credit, your local bank may prove to be the best source.

Customer/Supplier Financing — Customers can often be sympathetic about your need to maintain good cash flow. In some cases they may be willing to pay up front for part or all of the services or products you supply. Or, they may respond to discounts for early cash payments that will free up cash for operating your business.

Factoring or Accounts Receivable Financing — A company with cash flow problems can turn uncollected invoices into immediate funding by assigning its accounts receivable to a factor or agent.

Factoring usually involves high interest or a deep discount for which the factor assumes all risks involved with collecting payment.

Working Capital Financing — This type of funding works like a line of credit that's tied to your company's receivables and/or the dollar value of your inventory. For example, you might request that your lender provide a 70 percent advance on qualified receivables or advance 50 percent of the value of your inventory.

Economic Development Programs — Many federal, state, and local governments offer small businesses loan and incentive programs. The funding is typically administered through banks, business development districts, and the Small Business Administration. Often, special consideration is given to ethnic groups, women, veterans, and companies located in designated urban and rural locations. Funding through these special programs often requires a great deal of documentation, and may also require tangible assets, primarily real estate or equipment, as collateral.

Private Investors — "Angels" or venture capital investors typically take an equity stake in your company (usually preferred equity security) in exchange for funding. While this is a loan you won't have to repay, it's certainly not a free ride. You'll have to give up a portion of your equity, and some investors may insist on providing business direction as well as financing.

Types of Financing

No matter what business you're in — and whether you need financing for a start-up, expansion, or new development — there are two major types of business financing to consider.

Debt Financing — The most straightforward of funding options. It usually requires periodic interest payments and repayment of the borrowed principal within a specified time period.

Equity Financing — Involves raising capital by selling an interest in your business to investors. Instead of a guaranteed return, investors will have the opportunity to share in your company's profits. In many cases, they will also share in the management and control of your business.

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Stock Sale — Selling stock in your company generally requires compliance with federal and state securities laws and calls for the assistance of financial and legal professionals. That makes this type of funding an expensive undertaking. Initial Public Offerings (IPOs) are sales of stock that take private companies public. A Private Placement is a similar but less complex transaction that transfers stock to pre-selected equity investors. In both cases, stockholders typically exercise control over your company in direct proportion to the number of shares they own.

Fundamentals of an Effective Business Plan

A well-prepared business plan that defines your business and identifies your goals is an essential part of any request for financing. Additionally, a plan that details your financial history and future marketing plans can help you make good business decisions — and help potential funders make a decision in your favor. Here's what the plan should include:

- Executive Summary
- Description of Company
- Description of Product or Service
- Market Analysis
- Ownership Structure
- Management Team (including membership in any professional or trade organizations)
- Financial Advisers (including CPA, Attorney, etc.)
- Description of Business Model
- Summary of Business Operations
- Financial Statements

It Pays to be Prepared

The critical element in receiving approval for funding is whether or not your company qualifies as a “good risk.” Most lenders consider cash flow more important than profitability. When you apply for funding, you must be fully prepared to have your business undergo intense scrutiny. The groundwork you do in advance should uncover any issues that you’ll need to address during the funding process. You’ll dramatically increase your chances of securing funding if you have a well-prepared business plan that supports your need for financing. You should also be able to confidently answer the following questions:

Why do I need funding? How will the capital help my business?

Most lenders require that capital be requested for a specific purpose.

How much do I need to borrow? How urgent is the need — and is it short- or long-term?

You can obtain the best terms when you anticipate a shortfall or growth opportunity instead of looking for money under pressure.

Do I have a realistic plan to generate funds to repay the debt?

To approve a financing request, the funding source must have comfort that it will be repaid.

How strong is my management team?

This is perhaps the most critical element that money sources consider in approving funding.

Good preparation will benefit your business, simplify the funding process and enhance your ability to successfully secure funding.

How a CPA Can Help

A CPA often has established relationships with financial sources and may know which ones would be most receptive to working with your company. In addition, a CPA can help you prepare a business plan and present the information effectively. Perhaps most important, since CPAs know how a company can be managed profitably and positioned for growth, they can help you evaluate your funding options, including multiple source financing. Working closely with your CPA could help you secure the type of financing that will contribute to your company’s future growth.

Assemble Your Business Information and Financial Data

Whether you decide to go with debt or equity financing, there is a universal factor involved in being approved. Your business must be perceived as a good risk. It is extremely important that you be fully prepared for intense scrutiny of every aspect of your company.

In addition to a solid business plan, you should be prepared to provide pertinent business information and financial data including:

- Summary of the average amount of funds on deposit
- A list of investments, fixed assets, and other assets, with detailed or supplementary schedules, giving market or appraisal value where appropriate
- A list of major vendors, customers and competitors
- The aging of receivables, with details regarding any concentration among a few customers
- The details of notes receivable and the risks of collection
- Inventories with details on price stability, aging and turnover
- A statement of your liabilities and reserves with appropriate explanations
- A comparison of your operating and balance sheet ratios to industry averages
- A cash flow analysis of your actual past experience and projections of future income, expenses and cash flow
- Relevant financial data including sales forecasts, profit and loss statements, cash flow projections and balance sheets
- Miscellaneous documents that flesh out other important details of your operation, including copies of contracts, franchise agreements and tax returns

Do the Right Thing

Always be totally honest about your financial situation.

Don't try to hide or diminish past credit problems or current operating difficulties.

Be prepared to discuss business problems and steps to prevent them in the future.

Set reasonable projections with detailed plans for achieving goals. This will illustrate the level of thought you've given to making your business successful.

Be forthcoming. Candor will go a long way in demonstrating your resolve to succeed and the profit potential of your business.