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# The Facts of Financing

*Do you know your type?*

By: Aaron Dyer

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Your mother always warned, “Don’t put all your eggs in one basket” and those words of wisdom can be applied when financing a business. There are a number of methods that can aid buyers in financing a business. Buyers must recognize their available resources such as the seller, lenders, and investors.



As a child, we’re encouraged to “dream big” and told that nothing can stop us, but ourselves. As entrepreneurial adults, this idea of dreaming big is often a part of your everyday routine, but it is inevitable that at some point you’ll come crashing down from those heights into reality. The realization that financing your particular endeavor can instantly dampen even the most impassioned enterprising individual can get you down. To put it bluntly, “Don’t let it”.

Having a reality check on the difficulty of securing financing for a business can be the first step towards making your dream an actuality. There are numerous types of financing available, some more

unorthodox or obscure. If you take the time and effort to research all avenues for funding you will be rewarded.

There are two main types of financing: debt financing and equity financing. It is important to you and the success of your business that you familiarize yourself with the types of financing in order to choose, seek, and finally, obtain the right form for your needs.

Debt financing involves borrowing money that will be repaid over a certain allotted time with a set interest rate tacked on. The time of such financing can be short term or long-term. In most cases, short term financing would include repayment within one year, while long-term financing would entail repayment in a time period that exceeds one year.

An advantage of this type of financing is the fact that the lender will not gain ownership in your business. You remain in control and your only obligation to them is to make regular and timely payments. In the case of small startups, a personal guarantee is often needed to facilitate the closing of the financing deal.

Equity financing, unlike debt financing, will involve giving the financing entity a share in the business. Some business owners dislike the idea of losing any amount of control. On a positive note, this type of financing does not incur debt. This kind of freedom from debt can give a greater sense of security in starting a new business. In addition, some entrepreneurs find great value in their equity financing partners, and see their presence as an asset.

The type of financing you will choose is based largely on the needs of your business and the kind of collateral, or available assets you have to offer. A substantial amount of debt financing can lead to poor credit and a shortage of funds in the future due to an inability to apply for more financing. A business that becomes overextended, offers little collateral, and is steeped in debt is not an appealing option for many investors.

As previously mentioned, there are other more unorthodox methods of obtaining funds that can certainly prove to be beneficial to your business. Some options can be found in your own circle of friends and family. One benefit of this type of financing is obtaining the money and a silent partner who will most likely not interfere with your business. It can also eliminate some of the red tape involved with more traditional forms of financing. This does not mean you can simply use a verbal agreement or "shake on it" to signify and bind the transaction. This is still a strategic business move and you must treat it as such which means proper documentation, clear terms, and mutual understanding of those terms.

Relationships can be ruined over inept efforts with this type of financing, so value your business and the other person by treating it with professionalism, attention to detail, and respect. Don't become the black sheep at the next family reunion over some misunderstanding or your falling behind on payments.

A few other options that are largely unknown to those who haven't done research include unsecured loans and micro-loans. Resources such as TheSnapLoan.com or Prosper.com offer

loans based on cash flow, credit score, and debt-to-income ratio. Government grants are also a largely untapped resource that is made available to entrepreneurs. Simply researching the website Grants.gov can be extremely helpful in your search for funds.

Venture capital is another route that many entrepreneurs look to due to the amount of funding that can be procured. A venture capitalist will likely offer larger sums of money that can be of great assistance to your business, but they will also gain a certain portion of control and ownership. This type of funding however is usually scarce due to the assumption that many startups will inevitably fail. You will need to find someone willing to take the risk and who sees potential in your vision.

This type of person could also be found in a more palatable option known as the Angel investor. The Angel investor typically has a high net worth and like the venture capitalist, must believe in the product and the person behind the product. Their loan often converts to stock, preferred stock, or convertible bonds.

Les Brown, an author and entrepreneur, says, "Shoot for the moon and if you miss you will still be among the stars". This is an extremely appropriate sentiment as it encourages you to keep dreaming big and ultimately those dreams combined with perseverance and research will take you closer to where you want to be.

The following is a chart that demonstrates the normal financing options available to businesses in different stages of the business life cycle.

## Typical Financing Options for each Stage of Business

Stage of Business	Common Funding	Source of Money
Research Start-up	Personal funds, gift, loan or equity investment	Savings, salary, credit cards, line of credit, home equity line, retirement funds
Start-up Early growth Small and profitable business	External gift, loan, equity investment extension of trade credit	Friends, family, associates Suppliers, angel investors
Growing business	Commercial loan  Equity investment	Institutional lenders, such as banks  Institutional investors, such as venture capital

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### About the Author:

Aaron Dyer is President of Dyer Consulting Group, a small business consulting firm that advises business owners on ways to grow their revenues and increase profitability through better strategic planning and financial management. For more information, and also to sign up for Aaron's future articles, visit [www.DyerConsultingGroup.com](http://www.DyerConsultingGroup.com)

