Funding Sources for Small Businesses

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In today's economic climate of rising interest rates, the need for creative financing of a small business has become realty. This is even more accentuated when one takes into consideration that many private investors only look toward technology-oriented investments, such as the Internet, bio-medical research, medical equipment and computer-related fields where high returns may be realized.

Add to this the political and social climates that prevail relative to the shooting sports, and we quickly realize the importance of creative funding and financing for our businesses. With this in mind, I've developed the following list of sources you may have overlooked.

Yourself

The most logical place for individual businesspersons to look for financing is in their own assets. These sources include bank accounts, certificates of deposit, stocks and bonds, cash value in insurance policies, real estate, home equity, value of hobby collections, automobiles, pension funds Keogh or IRAs.

Family Members and/or Relatives

One common source of money is family members. Too often, however, money issues can complicate family relationships. Use extreme care in determining whether to approach a relative.

You can avoid future disagreements with relatives who lend you money for your business with a written agreement. Spell out clearly the terms to which you and your relatives have agreed: date of loan; loan amount; date the loan will be paid in full; dates of loan payments; frequency of payments (monthly or quarterly); amount (percentage) of interest; collateral, if any; and signature of both parties.

Friends

There is an old adage: "Don't mix business with pleasure." Frequently, however, friends represent an excellent source of funding for small business start-up or an ongoing business loan. When borrowing from friends, exercise the same caution and documentation you would with relatives to make sure borrowing will not result in the loss of friendship or cause serious rifts.

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Commercial Banks

Banks are the standard lending organizations for businesses. They represent the largest single source for loans and financing. Their basic business is to provide and manage money for individuals, businesses and organizations. Interest on loans is their major source of income.

The amount of interest charged by banks is based on some factor of the prime interest rate, the lowest rate banks charge their most favored customers. These customers generally are large companies and businesses.

Banks charge smaller and riskier customers an interest rate above the prime rate.

Savings and Loans

Savings and loans are similar to banks, but they are organized under a different charter. Originally established to facilitate the lending of money for home mortgages, they have evolved into full-service banking operations. There are some government restrictions on where and how they can operate as compared with commercial banks. Like banks, their charge for loans is based on a prime rate or some variation of it.

A scandal involving poor-risk loans rocked the savings and loan industry in 1991-1992. As a result, they now take a careful look at any business loan application. Many require that any loan be backed by an equivalent amount of collateral.

Leasing Companies

The role of leasing companies traditionally has been tied to providing motor vehicles for individuals and companies. This role gradually expanded to fleet leasing. Many leasing companies have even taken over the financing of cargo and passenger vehicles. In recent years, these companies have further diversified to finance the purchase of new inventory or leasehold improvements such as remodeling. They may even provide working capital.

Loan Companies

Loan companies represent one of the largest sources of funding in the U.S. Unlike banks, loan companies raise their own capital, so their interest rates usually are higher than the prime rate. Interest rates among loan companies also can vary significantly, and it is prudent to shop around before settling on one. Loan companies are considered collateral lenders, and they rely heavily on the borrower's ability to back up every dollar of the loan with a pledge or assets.

Insurance Companies

Existing companies can tap into insurance policies or pension funds for direct loans or for investment purposes. All three generally are interested only in making loans of substantial size. The loans usually are tied to some form of equity ownership.

Credit Unions

Credit unions were established with two objectives: to provide a savings vehicle for members; and to lend to members , primarily for automobile and appliance purchases. In recent years, they have expanded their lending operations to include nonmembers and investments outside of traditional financial investments. They seek out company start-ups and direct company loans where they can realize a higher rate of return or secure an equity interest in the companies to which they grant loans.

Private Investors

Private investors make investments and loans usually in exchange for an equity investment in a company. They work with existing companies or start-ups. Their objectives and funds available vary widely. Some limit their participation to under $50,000, while others may consider companies in need of half million dollars or more.

Generally, private investors want to make an investment in the company. They want no part of the day-to-day activities or ongoing business decisions. Most of these investors can be found through local banks, accountants, lawyers or your newspaper's classified advertising pages.

Local Development Companies

Local development companies are formed to attract new business to particular areas, frequently in rural communities and small towns. They usually are comprised of local banks, real estate firms and local business association members who band together to bring in new industry, and they often obtain their funds from unusual sources, such as the local board of education. These nonprofit institutions are in a position to offer land, buildings and capital.

Small Business Investment Companies

Small business investment companies are privately owned and licensed and insured by the U.S. Small Business Administration (SBA) to provide capital to small businesses. Companies usually focus on specific industries, such as medical technology, agriculture, manufacturing or real estate. Several small business investment companies exist in each state; to find them, contact the nearest office of the SBA or obtain a listing for your area from the U.S. Department of Commerce.

Customers

Customers or potential customers can be an excellent source of funding. A typical example is that of a shooter who wants to open a range. In conversations with a potential customer, it may turn out that they also want to start their own business. The customer invests in the range and a partnership is formed. One partner may manage the range and its employees while the other handles bookkeeping, advertising and customer service.

Suppliers

Suppliers are a good source of funding because they can be assured of becoming the principal supplier to a customer they've helped. They can provide supplemental equipment necessary for use with the products they provide. For example, food wholesalers often will provide display cases, shelving and other equipment.

Nontraditional funding sources are unlimited in number and type, but you need to be creative to acquire the necessary funds from them for your start-up or expanding business.