Capital: The Holy Grail for Small Businesses – Part 1

"If you would know the value of money, go and try to borrow some."
— Benjamin Franklin

In almost every survey, access to capital shows up as one of small business owners' top needs. But capital is not a singular item; indeed there are a wide variety of capital sources potentially available to small businesses. In my next two articles I wanted to talk about the various types of capital in the market, along with information about what sources are available to entrepreneurs today.

Ten years ago, entrepreneurs had access to a variety of capital sources. One of the most common sources was Home Equity Lines of Credit or HELOCs. LA home prices soared an astonishing (and unsustainable) 173 percent between 2000 and 2006, and lenders were rushing to lend money against those ever increasing values. At their heart HELOCs are a form of asset based lending and provided a great deal of liquidity for those looking for capital to start or expand their business.

Another long standing source of capital, for startups in particular, is family and friends, often referred to F&F (or sometimes FF&F). During that same period, incomes in a variety of industries were strong. This created opportunities for family and friends to invest $5,000 or $10,000 in a friend's business to help them get going and allow them to be part of a new business.

Credit cards, always an expensive source of seed capital, were seemingly arriving in the mail and credit limits were routinely raised. Finally a number of banks offered loans based solely on one's credit score. One major lender offered credit score loans as high as $100,000!

That environment is of course gone, and much of the easy credit that was available then will likely never return. As a result it's a much tougher world for business owners looking for capital to start or grow their business. What capital sources are out there today?

COMMERCIAL BANK LOANS – Bank loans have always been limited to a certain segment of the small business world – in essence there has to be have an entity that, **as it exists today,** has the capacity to pay back the loan. That means the business has to have a proven track record and the ability to pay back the loan with current cash flow, and/or there have to be assets or others tied to the loan that have that ability (e.g. a personal guarantee). Most startup or new businesses don't yet fit the profile for a bank loan.

SBA GUARANTEED LOANS – The Small Business Administration (SBA) provides loan guarantees that allow banks to make loans to businesses that don't quite qualify for a commercial bank loan. They generally offer more flexible terms and conditions. However in the end these are still bank loans that require the ability as the entity exists today to pay the loan back.

NON PROFIT LENDERS – Non-profit lenders typically offer smaller loans ($15,000 - $50,000 for example) and they will often be more creative and flexible in their underwriting guidelines. Several operate in the SCV including VEDC and PCR. These are still debt instruments, and as such they will still require the demonstrated ability to immediately begin paying the loan back. However they are worth exploring for early stage companies that are generating sales.

MICRO LENDERS – There are several nonprofit lenders that offer micro loans to small businesses. While the loan amounts available are small -- typically around $5,000 -- the application success rate is quite high, and their requirements generally are based on criteria that focus on your residency or your business size. Kiva.org has launched a new program that provides $5,000 loans to California small businesses. The Jewish Free Loan Association, offers similar sized micro loans to entrepreneurs of all faiths in the Los Angeles metro area. If a micro loan would make a difference in your business then these avenues are worth pursuing, as loans are generally made based on your standing as a target business, rather than your cash flow.

ASSET / RECEIVABLE BASED LENDING – often referred to as factoring. This form of financing is particularly popular in the fashion industry, but can be a resource for other industries that go a long time between placed orders and payment, such as the trucking industry or temporary staffing agencies. As with any form of financing, prices will vary and there are often a mixture of fees, terms and rates.

My next article will look at non-debt and newer sources of capital — stay tuned!

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