STEP 16

Funding options

How will you fund your business?

By now, you have almost done everything you need to turn your business idea into a potentially successful business. Moneywise, you know how much you need to get your business up and running. You have a pretty good idea of what it will cost to run it every month. It's time to think about how to fund your start-up. There are several different ways to fund your business.

1. Out of your own pocket

The easiest and most cost-effective way to provide your own financing for a new business is to use your personal savings.

Pros:

No loan to repay. No interest. It's your business, you don't have to give up a share of it.

Cons:

This can be risky, and you may not have enough to cover all the funding you need. If you use a credit card to fund the business and the business goes under, then you might spend the next decade paying it off.

2. Family and friends

It's common in the early stages of a business for family or friends to financially support your business. This option is most suitable for businesses that need initial support to prove the concept can be successful, to the point where they can seek other funding.

Pros:

It's a quick funding process with flexible terms. Depending on how much interest you pay, this could be a great investment for them.

Cons:

Mixing business with family and friends' finances can damage relationships if things go wrong. You'll need to carefully assess the possible impact of business failure before proceeding.

3. Crowdfunding

You raise the total amount of funding you need online from the general public. People can either lend you the money or take a share of your business. Businesses with a great growth potential that will attract plenty of attention.

Pros:

The larger the pool of people you reach, the more chance of getting a good deal.

Cons:

It can take a long time to hit your target, and you may have to invest a lot of time and effort in publicity.

4. Angel investors

Angel investors are wealthy individuals who provide funding in exchange for a share in your business. Some investors work in groups; others work on their own.

Pros:

Apart from the cash, angel investors will have experience and should be able to offer valuable business advice and guidance. You will receive mentorship where it's needed.

Cons:

You're likely to have to give up control of your business to some extent. Many will demand a large portion of your business, and 49 percent ownership is not unheard of.

5. Venture capitalists

These are investors who put in a considerable amount of money – generally a larger investment than an angel investor would provide – in exchange for equity in the business. Often their objective is to help the business to grow quickly, so that they can realise a good return on investment in a short time frame.

Pros:

In addition to the funding, venture capitalists offer expertise to help develop the business. They can also open doors to other contacts in their network.

Cons:

You're likely to have to give up a large chunk of your business, because of the significant amount of funding provided.

6. Incubators

These are programmes designed to scale and grow ambitious start-ups. They provide mentoring and a small seed investment in return for equity in the start-up.

Pros:

In addition to funding, these programs offer structured training and valuable expertise to help develop your business.

Cons:

The application and selection process can be gruelling.

7. Bank loan

Bank loans are still a popular source of funding for many start-ups. Banks are very risk averse, so this option is suitable for a business that has a good relationship with their bank, excellent credit, and is able to make a convincing and well-researched business case.

Pros:

You won't have to give up any control over your business.

Cons:

The process of getting bank finance can be complex and time-consuming. The challenge here is to prove that you will be able to make repayments. Banks tend to find first time business owners too risky.

8. Government grant funding

Government grants for small businesses are popular with start-up business owners because unlike bank loans that need to be repaid with interest, grant funding does not need to be repaid.

Pros:

You don’t have to pay the grant back. And you don’t have to give up any control of your business.

Cons:

The selection criteria are strict, the paperwork intense and it is a very lengthy process. Your business has to align with a specific project or initiative and you have to make sure you approach the best government agency for your business (they don’t work together or refer applications to each other).

9. Government departments and agencies

Numerous government departments and agencies offer support to start-up businesses ranging from small loans of a few thousand to loans into the millions. There are a number of government agencies you can approach.

Pros:

You won't have to give up any control over your business.

Cons:

The same as for the government grant funding.

Keep in mind that investors want to see business owners who –

- *understand their business and industry*
- *have high levels of business acumen*
- *run their business with honesty, integrity, and transparency*
- *clearly illustrate a passion for their business and industry*
- *understand their customers, market, and competitors well.*

The 5 Cs of Credit

Many traditional lenders evaluate the potential of small business owners using a framework called the five C's of credit. It's important to have a good understanding of what lenders are looking for in order to have to best chances of getting approved for business funding.

1. Capacity

Capacity is your business's ability to repay loans. Lenders want to be assured that your business generates enough cash flow to repay the loan in full.

2. Capital

Capital is the cash you put toward starting your business, and it's a good way to show a lender how serious you are about success. Keep a record that shows your investment in the business..

3. Collateral

Collateral is essentially a lender's backup plan – the assets you pledge to support your loan. Its significance varies depending on the type of loan, for example, auto loans, for instance, are secured by cars, and bonds are secured by homes.

4. Character

This is you. Lenders need to know that you are honest, trustworthy and have integrity. Additionally, the lender needs to be confident you have the skills, strengths, industry knowledge and experience required to successfully operate the business.

5. Conditions

Lenders want you to be able to demonstrate that there's a market for your business and a clear purpose for the loan. Base your arguments on the local and national economy, the competitiveness of the business, the type of industry and your experience in it, and your experience managing a business.

My funding

1. What funding options do I intend pursuing?

2. How much money do I want?

3. How much am I investing in the business?

4. Exactly how will the money be used?

5. How long do I need to repay the money?

6. How will the money be repaid?

7. What collateral do I have to offer (if required)?