principles of

Entrepreneurship

>>>> 14. Sources of Financing

Many entrepreneurs struggle to find the capital to start a new business. There are many sources to consider, so it is important for an entrepreneur to fully explore all financing options. He also should apply for funds from a wide variety of sources.

Personal savings: Experts agree that the best source of capital for any new business is the entrepreneur's own money. It is easy to use, quick to access, has no payback terms, and requires no transfer of equity (ownership). Also, it demonstrates to potential investors that the entrepreneur is willing to risk his own funds and will persevere during hard times.

Friends and family: These people believe in the entrepreneur, and they are the second easiest source of funds to access. They do not usually require the paperwork that other lenders require. However, these funds should be documented and treated like loans. Neither part ownership nor a decision-making position should be given to these lenders, unless they have expertise to provide. The main disadvantage of these funds is that, if the business fails and money goes lost, a valuable relationship may be jeopardized.

Credit cards: The entrepreneur's personal credit cards are an easy source of funds to access, especially for acquiring business equipment such as photocopiers, personal computers, and printers. These items can usually be obtained with little or no money paid up front and with small monthly payments. The main disadvantage is the high rate of interest charged on credit card balances that are not paid off in full each month.

Banks: Banks are very conservative lenders. As successful entrepreneur Phil Holland explains, "Many prospective business owners are disappointed to learn that banks do not make loans to start-up businesses unless there are outside assets to pledge against borrowing." Many entrepreneurs simply do not have enough assets to get a secured loan from a lending institution. However, if an entrepreneur has money in a bank savings account, she can usually borrow against that money. If an entrepreneur has good credit, it is also relatively easy to get a personal loan from a bank. These loans tend to be short-term and not as large as business loans.

Venture investors: This is a major source of funding for start-ups that have a strong potential for growth. However, venture investors insist on retaining part ownership in new businesses that they fund.

- Formal institutional venture funds are usually limited partnerships in which passive limited partners, such as retirement funds, supply most of the money. These funds have large amounts of money to invest. However, the process of obtaining venture capital is very slow. Several books, such as Galante's Venture Capital & Private Equity Directory, give detailed information on these funds.

- Corporate venture funds are large corporations with funds for investing in new ventures. These often provide technical and management expertise in addition to large monetary investments. However, these funds are slow to access compared to other sources of funds. Also, they often seek to gain control of new businesses.

- Angel investors tend to be successful entrepreneurs who have capital that they are willing to risk. They often insist on being active advisers to businesses they support. Angel funds are quicker to access than corporate venture funds, and they are more likely to be invested in a start-up operation. But they may make smaller individual investments and have fewer contacts in the banking community.

Government programs: Many national and regional governments offer programs to encourage small- and medium-sized businesses. In the United States, the Small Business Administration (SBA) assists small firms by acting as a guarantor of loans made by private institutions for borrowers who may not otherwise qualify for a commercial loan.