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February 2019

12 Ways to Fund a Business — and 4 "Rules" to Remember

Joe Ruvacalba, a plumber turned entrepreneur from Rancho Cucamonga, California, started his own plumbing company with just $10,000. Soon, however, he encountered cash flow problems.

"Your first client check might not arrive for 30 to 60 days. But you still have to pay for labor and material and everything else," Ruvacalba told a Money.CNN.com reporter in [an article weighing the costs of cash advances]().

Banks wouldn't lend to Ruvacalba, so he resorted to a merchant cash advance. The first was for $50,000 and included another $20,000 in fees and other charges. It was paid back within seven months, but Ruvacalba's challenges weren't over. He saw the only way to grow his business keep on top of his payroll expenses and pay back his previous cash advance was by securing *more* merchant cash advances.

Over four years, Ruvacalba took a total of $700,000 worth of merchant cash advances, which cost roughly $200,000 in fees and finance charges.

"As an owner, you have to ask yourself: 'Can I handle this payment every day?' And if you can't, don't take it," said Ruvacalba, who says he doesn't regret his decision. "I'm not going to bad-mouth somebody that was willing to help me when the banks weren't."

Where to Get Business Financing You Can Afford

Undercapitalization, or "not enough money," is one of the top reasons businesses fail. Yet in efforts to acquire the capital they need, sometimes the medicine can be worse than the disease.

Where can business owners turn for financing where they won't be bled dry?

Ruvacalba experienced the "good, bad, and ugly" of merchant cash advances or MCAs. They are often the "last resort" for business owners to obtain cash, especially on short notice and/or without business credit. But if you are a business owner, you should try to avoid

MCAs if possible. They often come with ugly fees and high costs that can trap business owners in cycles of debt.

So, what are some better options? Here are 12, including money from outside sources and ways to use your own assets for business funding.

Other People's Money:

1. Banks and Credit Unions

Major banks offer affordable financing with single-digit interest rates. Options include term loans, lines of credit (secured and unsecured) and equipment loans. It is often best to apply for interest only or long amortization schedule (20+-year) loans to keep payments as low as possible.

Unfortunately, major banks only approve 25% of loan applications, according to Forbes.com. You're twice as likely to be approved by a community bank or credit union, though you'll still need a strong application.
You've probably heard the saying, "banks only lend money to people who don't need it." That's also true with businesses. If your credit is not up to par, reach out to a credit specialist to fix it before going into business.

Don't have cash flow or enough assets? Just starting a business? Be prepared to look elsewhere.

2. SBA Loans

Contrary to popular belief, SBA loans do not come from the government. Rather, they come from various local banks (large and small) and credit unions and are guaranteed by the government. (They are the business equivalent of an FHA housing loan.) According to SBA.gov and Fundera.com, some of its programs include:

- *7(a) Loan Guarantee Program:* aimed at helping a business start or expand its services, funding is up to $5 million.
- *MicroLoan Program:* mostly used for short-term purposes, such as the purchase of goods, office furniture, transportation, computers, etc. The maximum amount is fixed at $50,000.
- *Community Advantage Loans ($50k-250k) and the 504 Fixed Asset Program (up to $5 million)* are for applicants whose business model will benefit their community by providing needed jobs or services in an underserved area.

The rates are very reasonable, and even start-ups can apply. But the application process is no picnic. You'll need a resume, a business plan, a description of how the money will be used, income tax returns, financial statements, and legal documents pertaining to your business. Your credit, your business's credit (if applicable) and your personal background will also be vetted. SBA business classes may also be required, which new business owners may find helpful.

David Waring, co-founder of FitSmallBusiness.com, says you are most likely to obtain an SBA loan if you have "an airtight business plan, a credit score of 700+, a high net worth, and home equity that the bank can use for collateral." (Then again, if you have all that, perhaps you don't *need* the SBA loan!) But don't count yourself out too soon — sometimes community lending sources that partner with SBA can be more flexible than you expect.

Lastly, there can be hefty pre-payment penalties as well as liens on personal assets, including your home. This can lock you up for years.

3. Peer-to-Peer Lending

Peer lending platforms are a cakewalk compared to banks. You can obtain up to $50,000 in a week or so from an online peer lending platform such as LendingClub.com or Bitbond.com. You still need to make your case as to why people should lend to you, your business needs at least a 12-month track record, and a good credit rating of 700+ helps. Rates vary from single digits upwards, according to your creditworthiness and other risk factors.

4. Crowdfunding

With crowdfunding platforms such as Kickstarter and Indygogo, the goal is to obtain a small amount of money from a large number of people. Musicians use crowdfunding to raise money to record and manufacture CDs. Tech gadgets and apparel businesses are also common. Sweatshirt entrepreneur Jake Bronstein raised a million dollars from over 9,200 backers to launch his "Ten-Year Hoodie," setting a Kickstarter fashion funding record that still stands.

5. Online Business Lenders

Fintech companies such as Kabbage.com and OnDeck. com have streamlined the process of obtaining financing for businesses and meet needs that are often unmet by traditional banks. They offer both term loans and lines of credit that can be funded in a week or less. These sources can be a good fit for people who either can't qualify or don't want to wait for bank financing. With starting rates currently ranging from 10-15% for the best borrowers, these lenders are substantially more affordable than a merchant cash advance. However, rates climb quickly for those with lower credit scores and other risk factors, so read the fine print.

6. Angel Investors and Venture Capitalists

Angel investors are wealthy individuals, whereas venture capitalists are typically companies or firms. They both have investable cash and are looking for opportunities for exceptional returns and ownership interest in a fast-growing business. They also offer invaluable knowledge and experience. However, be cautious, as they may want more control of your business than you would like to give them.

7. Friends and Family

This is an area where you must proceed very cautiously! The positive side is that you may have friends and family who believe in you and are willing to help. On the negative side, friendship and kinship don't always mix well with money. You should definitely have a business plan and write out a promissory note so that both parties understand the expectations and obligations.

8. Credit Cards

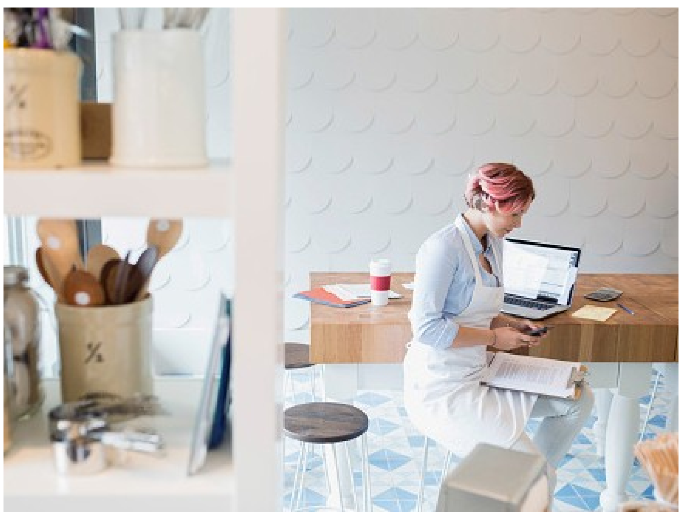
As you can imagine, this is not the best or cheapest source of business financing! We wouldn't suggest that it be a major source of funds; however, it can work well to use credit cards that you pay off monthly for convenience and for added perks, such as travel benefits.

According to Brian Tracy, 37% of business owners use credit cards (personal or business credit cards) to cover costs in their businesses. As with a line of credit, you'll want to secure the credit before you need it.

Your Own Savings or Investments:

9. Home Equity Line of Credit (HELOC)

A HELOC can be an excellent funding source, as it is secured against your home and therefore the interest rate tends to be low. According to FitSmallBusiness.com, HELOCs are used by 25% of business owners.



There are catches, though. You will typically need more than 20% equity in your home to benefit from a HELOC, and a minimum credit score of 620. And you will definitely want to set up the line of credit while you have a reliable and verifiable income source. And keep in mind, if the housing market declines or you make payments late, the bank can lower or freeze your credit line.

10. ROBS: Rollover as Business Start-up

In theory, this little-known way to fund a business is a great idea: Use the money in your own retirement plan to fund your business start-up, without paying the onerous taxes and fees that would be required if you cashed out. In fact, however, it is complicated, unwieldy, and full of rules and costs.

With a ROBS, you cannot use the money as you wish, nor can you remove it from your retirement account. Rather, you set up a C corporation for your business, and your retirement account buys shares in your business. (That's the short story. It's actually more complicated than that, and you'll pay about $5,000 to set it up, plus monthly maintenance fees, none of which can come from the rollover.) On the plus side, there's no interest charge or debt to repay.

11. Personal Investments

You may have savings accounts or brokerage accounts (outside of retirement accounts) that can be used. These are good sources to tap when you need to put some of your own skin in the game, which more traditional lenders often require. You may also explore using your retirement accounts. Keep in mind that you will owe taxes, and a 10% penalty may apply to withdrawals taken if you are under 59½ years old.

12. Whole Life Insurance Cash Value

Whole life cash value is a valuable component of a whole life policy.[1] The cash value of whole life can be a valuable funding source for several reasons:

- You can borrow or withdraw for any reason. There's no credit check or confirmation of income. You may wish to consider borrowing so that you continue to build your asset and replenish your funding source.[2]

- You can borrow against an asset that continues to *grow* — even while being used as collateral. Unlike your shoe box (or most savings accounts paying virtually nothing these days), the growth of your cash value may outpace inflation.[3]

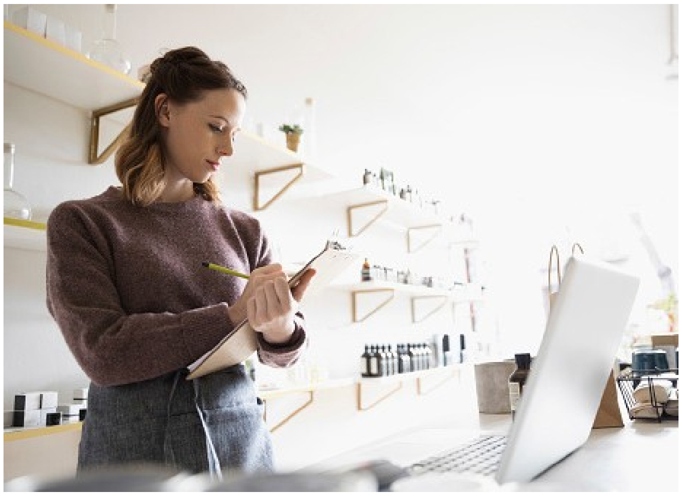
- Low interest. You can likely borrow against your policy for 4-8%, depending on how your policy was set up and whether it's a fixed or variable loan rate. But another great option is using your policy as collateral to borrow from a bank. A **Cash Value Line of Credit** (CVLC) is often tied to Prime or LIBOR. Can you see the potential of borrowing at a cost of 4-5% against an asset earning perhaps 4% tax-deferred? It is an advantage to borrow against your whole life when the growth of the collateral offsets the cost of your business funding.

Four Rules of Thumb of Business Financing

As we compiled the resources above, we couldn't help but notice that there are some common themes or "rules of thumb."

Rule #1: Your credit matters. Whether you're applying for a loan, a line of credit, or peer lending, good credit makes funding a business cheaper and easier. It's a good idea to bolster your credit *before* starting a business and try to keep your score high.

(There are exceptions. No one asks crowd funders what their credit score is — that's all about persuasion and networking. And your score does *not* matter when borrowing against your life insurance policy. Your policy determines the interest rate.)



Rule #2: It pays to plan ahead. More affordable business financing options typically have longer time frames. The faster you need the cash, the more expensive it will be.

The best option is to line up money *before* it's needed. Shark Tank's Barbara Corcoran advised an entrepreneur that it is better to use a credit line than give away equity in your business. However, to do this, you must establish the credit line while you still have plenty of cash. "They're not your friends — the banks, and they won't be there when you need them if you don't move early."

Rule #3: Savings save businesses! Those who save or build equity first have more options later. There is not only an advantage to having money, but entrepreneurs who have skin in the game tend to be more successful in business.

Savings are not the same as investments. You may have noticed that there's a catch to some of "your" assets. Even if you have money available in a retirement plan or home equity line of credit, you will still have to either qualify to get it or jump through some expensive and complicated hoops to access it.

The least restrictive sources of funding will be highly liquid, such as savings accounts, brokerage accounts outside of retirement plans, or whole life cash value.

Rule #4: If you have the determination… but lack savings, assets, or good credit, don't despair. Your mind- set matters, and if you *think* you can fund your business, you will find a way. Ultimately, there's no lack of money in the world, only a lack of determination.

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[1] Some whole life policies don't have any cash values in years one and two. Whole life insurance should be considered for its long-term value. Early cash value accumulation and early payment of dividends depend upon policy type and/or policy design, and cash value accumulation is offset by insurance and company expenses. Consult with your Guardian representative and refer to your whole life insurance illustration for more information about your particular life insurance policy.

[2] Policy benefits are reduced by any outstanding loan or loan interest and/or withdrawals. Dividends, if any, are affected by policy loans and loan interest. Withdrawals above the cost basis may result in taxable ordinary income. If the policy lapses, or is surrendered, any outstanding loans considered gain in the policy may be subject to ordinary income taxes. If the policy is a Modified Endowment Contract (MEC), loans are treated like withdrawals, but as gain first, subject to ordinary income taxes. If the policy owner is under age 59½, any taxable withdrawal may also be subject to a 10% federal tax penalty.

[3] Dividends are not guaranteed. They are declared annually by Guardian's Board of Directors.

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2018-65833 (Exp. 09/20)