Sources of Capital for Small Businesses

Whether you are starting or growing a business, it often “takes money to make money” as the saying goes. The purpose of this guide is to:

- alert you to resource organizations that can help you evaluate and prepare to pursue various sources of capital
- provide a brief overview of some funding options

This content is for informational purposes only and should not be construed as legal, accounting, investing, tax, or other advice. We strongly recommend you consult with professional advisors such as your business attorney, accountant, and banker before making a business financing decision.

This is not an all-inclusive list.

Organizations that provide business counseling at no cost

- Small Business Development Centers (SBDC) located around the state
- Idaho Women’s Business Center
- Treasure Valley SCORE and Eastern Idaho SCORE Chapters
- SBA

Bootstrapping

This term refers to using owner savings, gifts from family and friends, “sweat equity”, and customer revenues to fund your business startup or growth. It is the cheapest cost of capital, but it can limit your ability to scale your company quickly. For example, you may find that you need additional, outside funding to make investments in equipment, machinery, inventory, a physical location, additional hires, and more.

Grants

In general, it is difficult to find “free money” for your for-profit business. There are a few grant opportunities for small businesses that meet certain eligibility criteria. Examples of programs include STEP Grants for exporting activities and IGEM state grants or SBIR STTR federal grants for research and technology commercialization.

Equity Capital

In this scenario, you give up some equity (ownership) and some control in your company to an individual investor or an organized group of investors in exchange for the money they are
moving into your business. You and your investor(s) will share in the profits or losses and in decision making in proportion to your respective shares of stock in the company.

Angel investors, venture capitalists, and private equity firms are examples of organized groups of investors.

Please note that the Securities and Exchange Commission (SEC) has established rules determining what constitutes “an accredited investor”. Be sure to understand these conditions before taking on an investor.

Consider what talents, industry connections, and experience the investor(s) will bring to your company along with the capital. You may find the tips in this article helpful: [https://www.inc.com/tony-tjan/5-tips-for-choosing-an-investor.html](https://www.inc.com/tony-tjan/5-tips-for-choosing-an-investor.html)

Crowdfunding / Crowdsourcing

The intent is for the business to raise small amounts of money from a large number of people, typically using the Internet. A strong marketing plan and robust social media following will be critical to attract potential funders to the platform and then to your particular business project.

There are four basic models:

- Donation-based
- Rewards-based
- Equity-based (percentage ownership from investors)
- Debt-based (“peer to peer lending”)

Examples of some crowdfunding platforms include Kickstarter, Indiegogo, Go Fund Me, WeFunder, and Kiva.

Commercial or Business Loans

In general, lenders typically make loan decisions by focusing on what is called “The Five C’s of Credit”: Character, Capital, Capacity, Collateral, and Conditions. This article explains these categories.

[The 5 Cs of Credit (thebalance.com)](https://www.thebalance.com)

- Traditional / Conventional Business Loans
  - These loans are made by a financial institution, such as a bank or credit union, based on its underwriting criteria and the terms it sets. Typically, these loans are made to a company more than two years in business with few perceived risk factors and demonstrated profitability in current and past financial statements and tax returns.
  - If the financial institution is interested in providing funding to a company that does not quite meet these criteria, it may consider lending using a government guarantee program, such as SBA or USDA Rural Development, if eligible.
If the only factor standing in the way of a loan approval is that the business is short on collateral, the financial institution may consider working with Idaho Housing and Finance Association (IHFA) to access the Collateral Support Program.

- **Government-Backed Business Loans**
  - These loans are made by a financial institution, such as a bank or credit union or other eligible third-party lender, with backing by the SBA or USDA Rural Development. The government guarantee is intended to reduce risk for the lender and increase access to capital for the business. The lender extends the loan to a company based on its underwriting criteria and the terms it sets that must be within the parameters established by the SBA or USDA Rural Development. If the loan is not repaid, the lender and the government entity backing the loan share in the risk, and each accepts a portion of the loss.

  - **SBA Loan Guarantees**
    - For -profit companies that meet SBA eligibility requirements
    - 7a program
    - 504 program
    - Microlending (less than $50,000 requested)
    - Economic Injury Disaster Loans (EIDL)
    - Export Loans

  - **USDA Rural Development Loan Guarantees**
    - For for-profit and non-profit businesses, cooperatives, and federally recognized tribes locating in rural areas and meeting other eligibility requirements

- **Alternative Lenders**
  - If a business is turned down by a financial institution, it is still possible that the company can meet more flexible lending criteria from an alternative lender. Note that the alternative lender will typically charge an interest rate that may be a few percentage points higher than the bank or credit union might charge. This is to compensate the alternative lender for perceived risk factors.

    - **Economic Development Districts (EDD)**
    - Certified Development Financial Institutions (CDFIs) including Capital Matrix and Mofi.org that lend in Idaho
    - Some Idaho nonprofits have special programs, such as Economic Opportunity by Jannus Inc.
    - Some tribes have business funding programs, such as:
      - Home - Nimipuu Fund
      - About - North Idaho Native Fund
      - Shoshone-Bannock CDFI

**Other Types of Financing**
• **Equipment leasing**

• **Revenue Based Financing**
  o Companies with documented strong revenue growth may be candidates for this type of financing. Based on an agreement, investors receive a percentage share of the business income on a regular basis until a predetermined amount—typically a multiple of between three to five times the original amount invested into the business—has been paid.

• **Asset based lending**
  o **Accounts Receivable Financing (“Factoring”)**
  o **Purchase Order Financing**

• **Business Credit Card(s)**

• **ROBS – Rollover Business Startups**
  o This financing method allows an entrepreneur to establish a new business or purchase an existing business or franchise by forming a C-corporation, with the shares in this new company being purchased with funds from the entrepreneur’s “qualified” retirement account. IRS code, ERISA law, and Department of Labor rules are involved, and it can be complex to initiate this process and fulfil ongoing requirements. Be sure to work with an accountant, business attorney, and benefits provider experienced with this funding structure.

• **Private Money Lenders**
  o These are individuals or an organization that agrees to lend a specified amount of money to a business on terms the private lender and the business owner agree upon. If the private loan is backed by real estate, it is often referred to as “hard money lending.”

• **Industrial Revenue Bonds / Private Activity Bonds**
  o These bonds finance the construction, enlargement or equipping of manufacturing facilities and a limited number of non-manufacturing facilities. Generally, for-profit companies can use these federally tax-exempt revenue bonds to finance:
    ▪ Manufacturing facilities
    ▪ Production
    ▪ Processing
    ▪ Assembly
    ▪ Solid waste disposal
    ▪ Local housing authorities

There are Idaho incentives that may apply to your business projects:

• **Idaho’s State Historic Preservation Office** has a Tax Credit Program to encourage private investment in historic building. For certain qualifying projects, the owner may claim 20% of their rehabilitation project costs as investment tax credits that can be applied toward his/her federal income tax.

• Idaho Department of Commerce has created a financial incentives and tax credits “one sheet” for businesses as well as a frequently asked questions (FAQs) page.