When the Bank Says No
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Your business needs green in order to grow. If a bank loan's not in your cards, angel investors and venture capitalists might be able to help. Find out if equity financing is right for your business.

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Every business is different. And yet, all businesses are exactly the same. That's because in spite of their unique industries, products, services or customers, all companies need just one thing, fundamentally, in order to grow. They need money.

Not all money is created equal, however. When your business needs financing, it has many options, each of which comes with different strings attached. Basically, though, there's your money, and then there's other peoples' money.

"There are different components of the capital food chain," says investor Bill Payne, a member of the Vegas Valley Angels, a Nevada-based angel investment organization. "The first source of capital for start-up entrepreneurs is their own personal resources. The second source of capital is friends and family; you can usually raise as little as $10,000 and as much as $100,000 from them. When you need moneys over $250,000, you might go to angel investors; you might even go to them a couple of times. And finally, when you need moneys above $4 million, you go to venture capitalists."

Which link on the so-called capital food chain is best for your company depends on the size, stage and strategic objectives of your business. The good news is: There's something for everyone.

Debt vs. Equity Financing

Once you've exhausted your personal resources—and both banks and investors alike will expect you to do just that before you knock on their door—you've got two fundamental financing options available to you.

Your first option is debt financing, which consists of good old-fashioned bank loans. Typically granted to businesses that need cash to fund operational expenses, seasonal droughts or major equipment purchases, loans are every company's first line of capital defense. That's because they allow you to get what you need while still retaining total control of your business. While you have to pay them back, the only major drawback—interest—is typically a tax-deductible expense.

"If an entrepreneur can grow his company with internally generated cash, or get his company in a position that it can justify debt financing, that's always the route to take," Payne says.

Unfortunately, not all companies are good loan candidates. "The bank wants to see a conventional business model that it's seen 100 times before," says Ron Wiener, a Seattle-based entrepreneur who recently started Earth Class Mail, an online P.O. Box services that is his fifth investor-backed venture. "It wants to see a printing company, a dry cleaners, a franchise."

What banks don't want to see, however, are new ideas or new companies. Generally speaking, start-ups are just too risky in their book.

"For most entrepreneurs, debt financing is really not an option for starting a company," Payne admits.

Equity financing, however, is. Unlike banks, equity investors don't expect to be paid back. They do, however, expect to get a large return on their investment—and they typically buy up to a third of your company in order to get it.

"If you're [an entrepreneur] because you're unhappy working for other people, and you're just trying to make money for yourself, you shouldn't go to equity investors," Wiener cautions. That's because equity investors don't want to invest in one person with lots of ideas; they want to invest in one idea that can affect lots of people. "Are you a small business, or are you a start-up that's trying to be a big business?" It's the latter, Wiener says, that are the best candidates for equity capital.

Angel Investors

When it comes to equity investors, there are two major types. The first are angel investors, so named for their role as veritable saviors to struggling yet innovative entrepreneurs. While many angels, including Payne, exist within larger angel investment groups, most are individual local investors who are looking to invest in local companies within their local economies.

"A lot of angel investors just like to be involved," Wiener says. "Getting a return on their investment isn't always something they expect. They just like participating."

In fact, angel investors aren't good only for their money. They're also great for their advice, as many are veteran business owners and executives who will sit on your Board of Directors and provide you with heaps of free wisdom; after all, your success is their success.

Angel investors are most appropriate for early-stage start-ups with little or no revenues. That's not to say that they'll give financing to anyone, though. Indeed, angel investors often have strict criteria for the companies that they fund. They'll look at your size, your revenue stream, your market, your management team and more. They'll also look at your exit strategy, as angels tend to require a way out, via a public offering or a buyout by a larger firm, after a period of roughly five to 10 years. In other words, they're not looking to invest in your family business; they're looking to invest in a business that can grow and, one day, be sold to the highest bidder.

Of course, the prospect of selling your company isn't the only reason to think extra carefully about angels before engaging them. Another reason is the vigorous screening process. "It's time consuming and it takes you away from your primary business, which is running your company," Payne says. "Basically, you're getting married."

If you still want to pursue angel investors, you can find them in nearly every major metropolitan area in the United States. A good place to start is with your local Small Business Development Center. Other good resources are accounting firms, universities business incubators and venture capital clubs.

Venture Capital

Speaking of venture capital, venture capitalists offer another type of equity funding for small business owners. Unlike angel investors, though, venture capitalists tend to look for more established companies, as well as companies with larger investment needs. According to Wiener, they're looking for serious companies with serious growth potential.

"We're talking companies that can reach $25 million in annual revenues within five years," he says.

Venture capital is extremely hard to come by, but can provide enormous opportunities for companies with revolutionary ideas.

If you want to try courting venture capitalists, Wiener suggests studying them first. "Go online and do your research," he says.

Of the nation's thousands of venture capital funds, identify fewer than 20 to which you'll send your business plan. The key to success, Wiener says, is to find venture capitalists that explicitly support companies in your industry and in your stage of development. Send them a solid business plan, including extensive profiles of your executive team and a plan for helping them profit from their investment, and prove to them that you'll be taking incredible risks alongside them. Most important of all, though, offer them innovation.

Says Wiener, "Show them something new."

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