

Successful Accounting/Financing for Small Business

Financing Overview



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Financial Management

- Financial Management
 - Financial management deals with two things:
 - raising money and
 - managing a company's finances in a way that achieves the highest rate of return

Financial Management

The financial management of a firm deals with questions such as the following on an ongoing basis:

- How are we doing? Are we making or losing money?
- How much cash do we have on hand?
- Do we have enough cash to meet our short-term obligations?
- How efficiently are we utilizing our assets?
- How does our growth and net profits compare to those of our industry peers?
- Where will the funds we need for capital improvements come from?
- Are there ways we can partner with other firms to share risk and reduce the amount of cash we need?
- Overall, are we in good shape financially?

Financial Objectives of a Firm

Profitability

A company's ability to make a profit

Liquidity

A company's ability to meet its short-term obligations

Efficiency

How productively a firm utilizes its assets

Stability

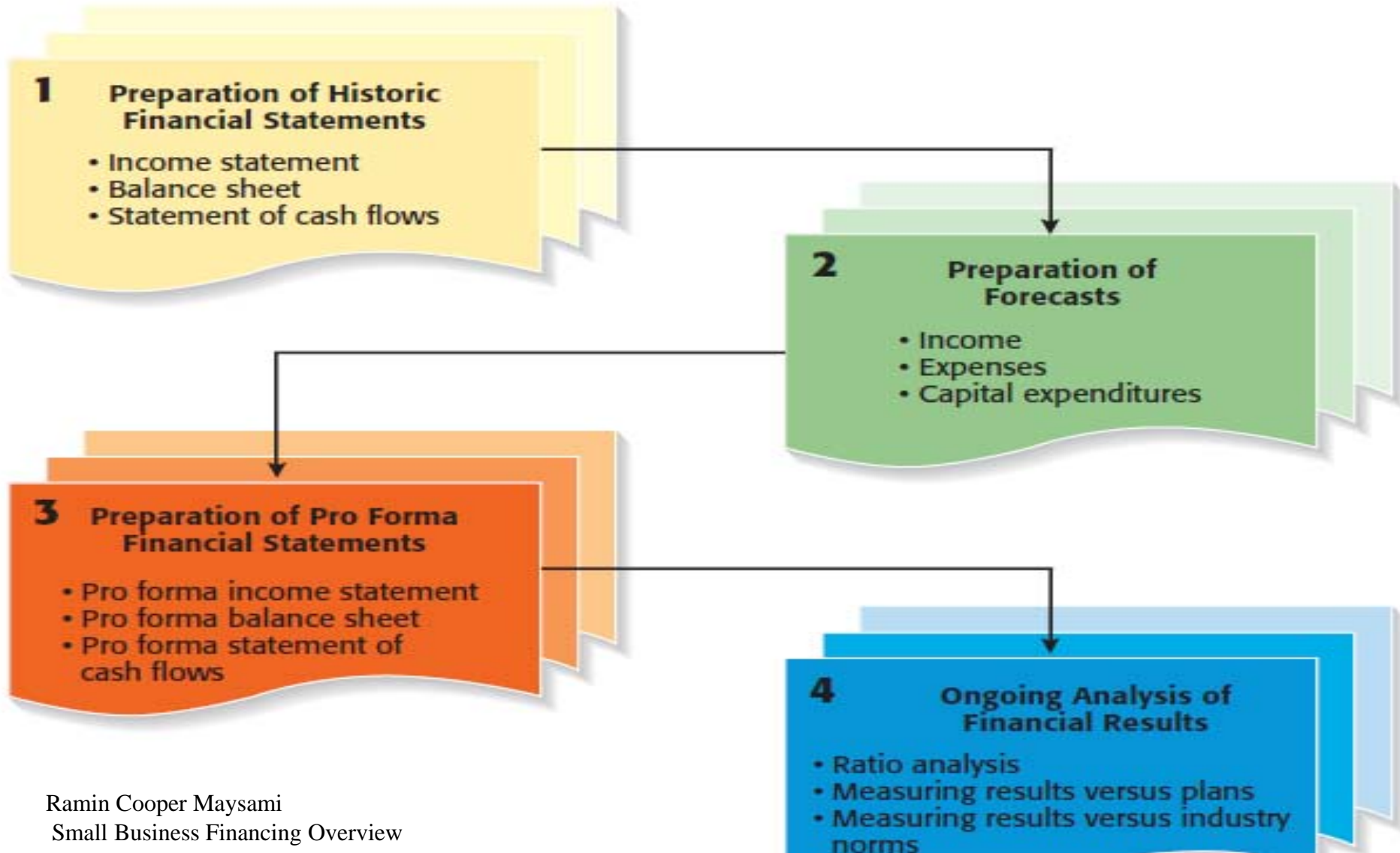
The overall health of the financial structure of the firm, particularly as it relates to its debt-to-equity ratio

Financial Objectives of a Firm

- Profitability
 - Is the ability to earn a profit.
- Liquidity
 - Is a company's ability to meet its short-term financial obligations
- Efficiency
 - Is how productively a firm utilizes its assets relative to its revenue and its profits
- Stability
 - Is the strength and vigor of the firm's overall financial posture.

The Process of Financial Management

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Financial Statements

- Historical Financial Statements
 - Reflect past performance and are usually prepared on a quarterly and annual basis.
- Pro Forms Financial Statements
 - Are projections for future periods based on forecasts and are typically completed for two to three years in the future.

Forecasts

- Forecasts
 - The analysis of a firm's historical financial statements are followed by the preparation of forecasts.
 - Forecasts are predictions of a firm's future sales, expenses, income, and capital expenditures.

Pro Forma Financial Statements

- Pro Forma Financial Statements
 - A firm's pro forma financial statements are similar to its historical financial statements except that they look forward rather than track the past.
 - The preparation of pro form financial statements helps a firm rethink its strategies and make adjustments if necessary.
 - The preparation of pro forma financials is also necessary if a firm is seeking funding or financing.

Ratio Analysis

- Ratio Analysis
 - The most practical way to interpret or make sense of a firm's historical financial statements is through ratio analysis, as shown in the next slide.
- Comparing a Firm's Financial Results to Industry Norms
 - Comparing a firm's financial results to industry norms helps a firm determine how it stacks up against its competitors and if there are any financial “red flags” requiring attention.



What Can I do For You?

Show Me The Money!!!

Why Most New Ventures Need Financing or Funding

Cash Flow Challenges

Inventory must be purchased, employees must be trained and paid, and advertising must be paid for before cash is generated from sales.

Capital Investments

The cost of buying real estate, building facilities, and purchasing equipment typically exceeds a firm's ability to provide funds for these needs on its own.

Lengthy Product Development Cycles

Some products are under development for years before they generate earnings. The up-front costs often exceed a firm's ability to fund these activities on its own.

Alternatives for Raising Money for a New Venture

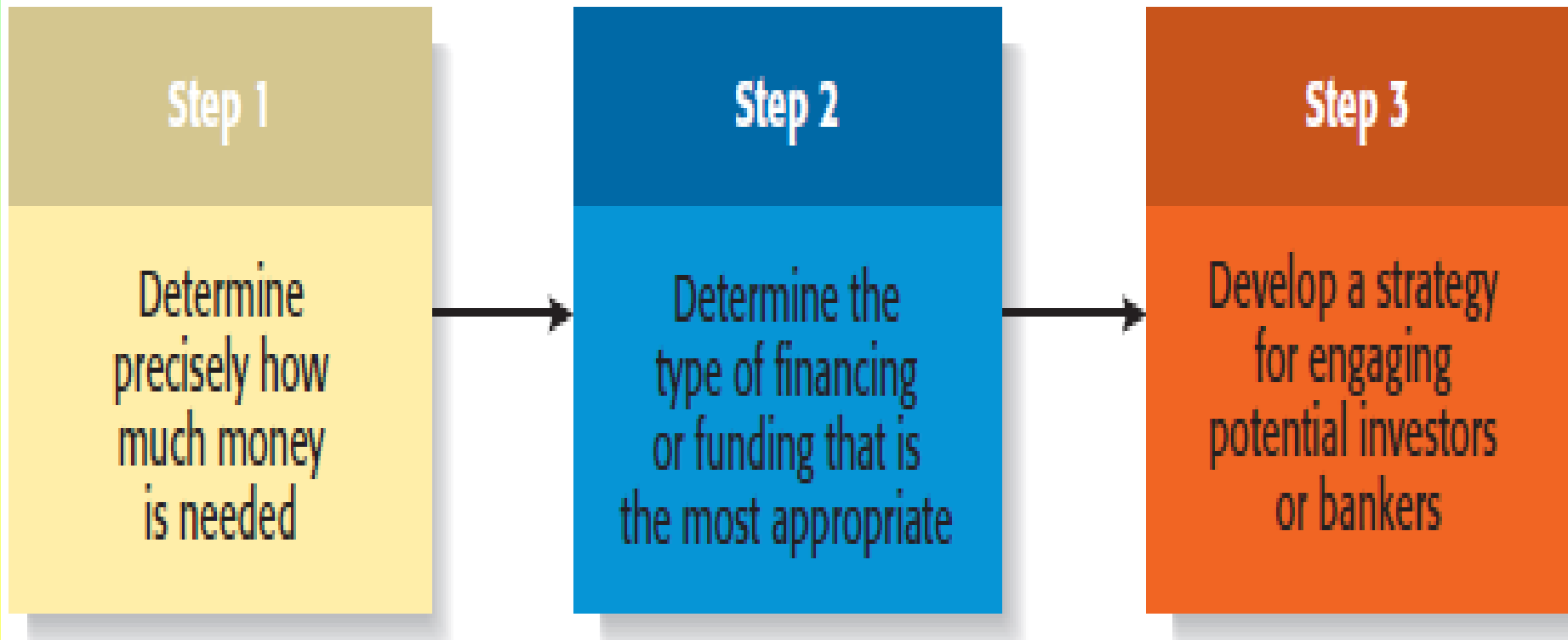
Equity Capital

Debt Financing

Creative Sources

Personal Funds

Preparing to Raise Debt or Equity Financing



Preparing to Raise Debt or Equity Financing

Two Most Common Alternatives

Equity Funding

Means exchanging partial ownership in a firm, usually in the form of stock, for funding.

Debt Financing

Is getting a loan.

Sources of Equity Funding

Venture Capital

Business Angels

Initial Public Offerings

Business Angels

- Business Angels
 - Are individuals who invest their personal capital directly in start-ups.
 - The prototypical business angel is about 50 years old, has high income and wealth, is well educated, has succeeded as an entrepreneur, and is interested in the startup process.
 - The number of angel investors in the U.S. has increased dramatically over the past decade.

Business Angels

- Business Angels (continued)
 - Business angels are valuable because of their willingness to make relatively small investments.
 - These investors generally invest between \$10,000 and \$500,000 in a single company.
 - Are looking for companies that have the potential to grow between 30% to 40% per year.
 - Business angels are difficult to find.

Business Angels

- Business angels are difficult to find.
 - The Network of Business Angels and investors
 - <http://www.nbai.net/>
 - World Business Angels Association
 - <http://www.wbaa.biz/about-WBAA.html>
 - Angel Investment Network
 - <http://www.midatlanticinvestmentnetwork.com/home>

Venture Capital

- Venture Capital
 - Is money that is invested by venture-capital firms in start-ups and small businesses with exceptional growth potential.
 - Venture-capital firms are limited partnerships of money managers who raise money in “funds” to invest in start-ups and growing firms.
 - The funds, or pool of money, are raised from wealthy individuals, pension plans, university endowments, foreign investors, and similar sources.
 - A typical fund is \$75 million to \$200 million and invests in 20 to 30 companies over a three- to five-year period.

Venture Capital

- Venture Capital (continued)
 - Venture capital firms fund very few entrepreneurial firms in comparison to business angels.
 - Many entrepreneurs get discouraged when they are repeatedly rejected for venture capital funding, even though they may have an excellent business plan.
 - Venture capitalists are looking for the “home run” and so reject the majority of the proposals they consider.
 - Still, for the firms that qualify, venture capital is a viable alternative for equity funding.

Initial Public Offering

- Initial Public Offering
 - An initial public offering (IPO) is a company's first sale of stock to the public. When a company goes public, its stock is traded on one of the major stock exchanges.
 - Most entrepreneurial firms that go public trade on the NASDAQ, which is weighted heavily toward technology, biotech, and small-company stocks.
 - An IPO is an important milestone for a firm. Typically, a firm is not able to go public until it has demonstrated that it is viable and has a bright future.

Initial Public Offering

Reasons that Motivate Firms to Go Public

Reason 1

Is a way to raise equity capital to fund current and future operations.

Reason 2

Raises a firm's public profile, making it easier to attract high-quality customers and business partners.

Initial Public Offering

Reasons that Motivate Firms to Go Public

Reason 3

Is a liquidity event that provides a means for a company's investors to recoup their investments.

Reason 4

Creates a form of currency that can be used to grow the company via acquisitions.

Sources of Debt Financing

Commercial
Banks

SBA Guaranteed
Loans

Commercial Banks

- Banks
 - Historically, commercial banks have not been viewed as a practical sources of financing for start-up firms.
 - This sentiment is not a knock against banks; it is just that banks are risk adverse, and financing start-ups is a risky business.
 - Banks are interested in firms that have a strong cash flow, low leverage, audited financials, good management, and a healthy balance sheet.

SBA Guaranteed Loans

- The SBA Guaranteed Loan Program
 - Approximately 50% of the 9,000 banks in the U.S. participate in the SBA Guaranteed Loan Program.
 - The program operates through private-sector lenders who provide loans that are guaranteed by the SBA.
 - The loans are for small businesses that are not able to obtain credit elsewhere.
- The 7(A) Loan Guaranty Program
 - The most notable SBA program available to small businesses.

SBA Guaranteed Loans

- Size and Types of Loans
 - Almost all small businesses are eligible to apply for an SBA guaranteed loan.
 - The SBA can guarantee as much as 85% on loans up to \$150,000 and 75% on loans over \$150,000.
 - An SBA guaranteed loan can be used for almost any legitimate business purpose.
 - Since its inception, the SBA has helped make \$280 billion in loans to nearly 1.3 million businesses.

Other Sources of Debt Financing

- Friends and Family
- Credit Cards
 - Should be used sparingly.
- Peer-to-Peer Lending Networks
 - Examples include Propser.com and Zopa.com.
- Organizations that Lend Money to Specific Groups
 - An example is Count Me In, an organization that provides loans of \$500 to \$10,000 to women starting or growing a business.

Creative Sources of Financing or Funding

Leasing

Small Business
Innovation
Research Grants

Other Grant Programs

Strategic Partners

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Other Grant Programs

Strategic Partners

Leasing

- Leasing
 - A lease is a written agreement in which the owner of a piece of property allows an individual or business to use the property for a specified period of time in exchange for payments.
 - The major advantage of leasing is that it enables a company to acquire the use of assets with very little or no down payment.

Leasing

- Leasing (continued)
 - Most leases involve a modest down payment and monthly payments during the duration of the lease.
 - At the end of an equipment lease, the new venture typically has the option to stop using the equipment, purchase it for fair market value, or renew the lease.
 - Leasing is almost always more expensive than paying cash for an item, so most entrepreneurs think of leasing as an alternative to equity or debt financing.

SBIR and STTR Grants

- SBIR and STTR Programs
 - The Small Business Innovation Research (SBIR) and the Small Business Technology Transfer (STTR) programs are two important sources of early-stage funding for technology firms.
 - These programs provide cash grants to entrepreneurs who are working on projects in specific areas.
 - The main difference between the SBIR and the STTR programs is that the STTR program requires the participation of researchers working at universities or other research institutions.

SBIR and STTR Grants

- SBIR Program

- The SBIR Program is a competitive grant program that provides over \$1 billion per year to small businesses in early-stage and development projects.
- Each year, 11 federal departments and agencies are required by the SBIR to reserve a portion of their R&D funds for awards to small businesses.
- Guidelines for how to apply for the grants are provided on each agency's Web site.

SBIR and STTR Grants

- SBIR Program (continued)
 - The SBIR is a three phase program, meaning that firms that qualify have the potential to receive more than one grant to fund a particular proposal.
 - Historically, less than 15% of all phase I proposals are funded. The payoff for successful proposals, however, is high.
 - The money is essentially free. It is a grant, meaning that it doesn't have to be paid back and no equity in the firm is at stake.
 - The small business receiving the grant also retains the rights to any intellectual property generated as the result of the grant initiative.

SBIR and STTR Grants

SBIR Three-Phase Grant Program

| Phase | Purpose of Phase | Duration | Funding Available (Varies by Agency) |
|-----------|--|----------------|---|
| Phase I | To demonstrate the proposed innovation's technical feasibility | Up to 6 months | Up to \$100,000 |
| Phase II | Available to successful Phase I companies. The purpose of a Phase II grant is to develop and test a prototype of the innovation validated in phase I.* | Up to 2 years | Up to \$750,000 |
| Phase III | Period in which Phase II innovations move from the research and development lab to the marketplace. | Open | No SBIR funding available, however, federal agencies may award non-SBIR funded follow-on grants or contracts for products or processes that meet the mission needs of those agencies, or for further R&D. |

Other Grant Programs

- Private Grants
 - There are a limited number of grants programs available.
 - Getting grants takes a little detective work.
 - Granting agencies are low key, and must be sought out.
- Other Government Grants
 - The federal government has grant programs beyond the SBIR and STTR programs.
 - The full spectrum of grants available is listed at www.grants.gov.
 - Be careful of grant-related scams.

Strategic Partners

- Strategic Partners
 - Strategic partners are another source of capital for new ventures.
 - Many partnerships are formed to share the costs of product or service development, to gain access to particular resources, or to facilitate speed to market.
 - Older established firms benefit by partnering with young entrepreneurial firms by gaining access to their creative ideas and entrepreneurial spirit.

Sources of Personal Financing

- Personal Funds
 - The vast majority of founders contribute personal funds, along with sweat equity, to their ventures.
 - Sweat equity represents the value of the time and effort that a founder puts into a new venture.
- Friends and Family
 - Friends and family are the second source of funds for many new ventures.

Sources of Personal Financing

- Bootstrapping
 - A third source of seed money for a new venture is referred to as bootstrapping.
 - Bootstrapping is finding ways to avoid the need for external financing or funding through creativity, ingenuity, thriftiness, cost-cutting, or any means necessary.
 - Many entrepreneurs bootstrap out of necessity.

Sources of Personal Financing

- Why Bootstrap
 - No Available Funding
 - Limited Sources of External Funds for Startups
 - A Desire to maintain 100% ownership and control
 - Minimum exposure to risk
 - Create a more effective business
 - The need to “look big”
 - Increase income and wealth
 - Stewardship and prudence

Examples of Bootstrapping Methods

Buying used instead of new equipment.

Coordinate purchases with other businesses.

Leasing equipment instead of buying.

Obtaining payments in advance from customers.

Minimizing personal expenses.

Avoiding unnecessary Expenses.

Buying items cheaply but prudently via options such as eBay.

Sharing office space or employees with other Businesses.

Hiring interns.

Bootstrapping Key Fixed Costs

Facility Cost

The Virtual Office

Free Use of Space

Bartering for Space

Incubators

Find the most
cost-effective space
to lease

Negotiating Rent Deals

Bootstrapping Key Fixed Costs

Furnishing, Equipment
and Other Start Up
Costs

Communication
and IT Cost

Transportation Costs

Business Insurance Costs

Legal, Accounting, and
other Consulting Costs

Staffing and Human Resource Bootstrapping

Types of Employees

Employee Stretching

Timing of Hiring

The Virtual Team

- Profit Sharing
- Equity-Like Compensation
- Paid Vacations
- Employee Discount
- Employer Sponsored Health Plans

Other Compensation and Benefits

Non-Salary Compensation

Using Student Interns

Employee Leasing and Temporary Employees

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