Ask a VR Intermediary

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Where Do I Go to Look for Capital?

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Dear Lee,

When you are seeking capital, most financial institutions provide only limited types of financing due to the specialization of these American markets. You will only waste time and effort if you approach the wrong type of financial institution.

When determining the appropriate financial institution, understand that they have criteria for acquisition lending. This takes into consideration such factors as a company's size, stage of its growth and potential for further expansion, location, industry that it is in as well as financial strength.

Keep note that the financial world is broadly categorized into lenders, investors and development financing institutions:

Lenders loan money-debt, in their manner of speaking for a specified period of time at a given interest rate. They expect regular payments of principal and interest.

For example, bankers are normally risk averse because they do not charge enough to compensate for high risk. Bankers usually lend on the basis of the company's historical and projected cash flow, debt service capability, guarantees and collateral.

Investors buy equity - a share of ownership in the business. They typically expect to get their original investment and return on it through sales of stock at a later date.

Venture Capitalists are one type of investor that put their money in start-ups and emerging businesses. They are generally hard bargainers that will demand a big chunk of the equity if they like your company and want to invest.

Development Financial Institutions are usually federal, state or local agencies with a mandate to promote certain forms of economic activity that may offer debt, equity or a combination of both. These sources offer cheaper financing for the purpose of achieving social benefits such as creating jobs, promoting exports, developing technologies, assisting minority citizens and spurring moribund local economies.

Your Needs vs. the Lender's Goals

In order to fulfill your capital needs, your financial sources goals must match. Lenders have different capacities to finance and absorb risk. For example, if you are seeking debt financing, be sure to borrow against fixed assets like equipment and real estate rather than against cash flow. In addition, use your equity for working capital; and remember to finance short-term assets such as working capital with short-term debt such as a line of credit, while financing long-term debt.

However, short-term debt should never be used to acquire long-term fixed assets; and it will be nearly impossible to raise debt financing to purchase a company that shows loss - selling a stake in your venture will be the only way to get money for that purpose. If your acquisition needs correspond to the goals of the investing or lending institution, raising money becomes easier.

Lenders Come in Many Forms

If you are seeking capital, know the different types of lending institutions that are available. You should understand how lenders expect to be repaid, and how they reduce risk:

Commercial Banks do all types of loans, but they will not take risks and can't spend large amounts of time with any single customer.

Commercial Finance Companies provide working capital to companies that are experiencing growth in inventory and accounts receivable.

Leasing Companies finance equipment by renting it out for a fixed period of time.

Suppliers

These are primary sources of credit. Be sure that you have a good credit rating and that suppliers are aware of it, since the cost of credit is built into their pricing.

When you do receive a loan, be aware that a lender expects to be repaid through the cash flow of the business. Collateral or anything of value that could be sold to pay back the loan can include company inventory, accounts receivable, equipment, real estate, stocks and bonds as well as savings accounts.