



# How to Finance a Start-Up Business

What are the steps and tools needed to finance your new business?



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## Business Plan

- Mission and Vision Statement
- Product or Service Description
- Market Analysis
- Management Description
- Marketing Plan
- Opportunities and Challenges
- Cash Flow Statement and Revenue Projections

## Other Essentials

- Location Selection
- Business Operations
- Business Registration
- Business Finance
- Business Lending
- Business Funding (Grants)
- Human Resources
- Marketing
- Taxes



## Harriet Parker, Manager Small Business Development Center Waubonsee Community College



Ms. Parker has over 20 years experience managing successful start-up businesses, where she played a key role designing and marketing software products that are in use nationwide today.

In addition to her role with the Illinois SBDC, she also is co-owner of HubTack, Inc. a web-based business serving land surveyors and engineers. Ms. Parker actively supports the local business community through her involvement on numerous boards and committees.



## What we will discuss:

- Identify financing options for a business:
  - Debt
  - Equity (Investors, Self)
  - Grants/Awards
- Define business costs:
  - Start-up
  - Fixed
  - Variable
- Understand financial statements:
  - Balance Sheet
  - Income Statement (or Profit & Loss Statement)
  - Cash Flow Statement

Agenda



## Equity Financing

**Definition:**  
Funds provided in exchange for full or partial ownership of the business.

### Funder options

- Owners
- Friends & Family (equity position vs. gift or loan)
- Angel Investors
- Venture Capitalists

### Equity Funding notes

- Owner funds should be tracked and accounted for as a business investment to assure owner receives full credit for equity investment.
- When taking equity funding from Friends and Family, an attorney should be consulted so the investment is structured properly.
- Equity funding involves giving up a percentage ownership of your business.
- Outside investors rarely fund start-up or "life-style" businesses.



## Debt Financing

**Definition:** Funds provided by a bank or other entity, to be paid back by the borrower over some period of time, plus interest (usually). The funder has the right to enforce repayment, and typically takes some form of collateral at surety.

### Loan types

- SBA Loans
  - 7(a)
  - 504
- Term loan
- Line of Credit
  - Credit Cards
- Alternative/Micro-Loans
  - Accion Chicago
  - Duman Center
  - Justine Petersen





## Debt Financing – Qualifying Criteria

### 5 C's of Credit

- Credit – Your credit score and related credit history is the first thing evaluated by a lender. It signifies level of risk and can disqualify you regardless of the strength of the other C's.
- Collateral – Assets pledged that can/will be liquidated if you fail to honor the repayment conditions of the loan. A start-up must usually pledge personal assets, since the business does not yet have assets.
- Cash Flow (aka Capacity) – Existing sources of income that will be used to make the loan payments as well as cover your personal living expenses. Lenders assume that a start-up business will not generate positive cash flow in the short term.
- Conditions – Economic, industry or other external conditions that impact a lender's willingness to make a loan.
- Character – Borrower's expertise or experience/ability to successfully execute the business plan. For example, someone with restaurant operations experience has a better chance of procuring a loan for a restaurant than someone who has a great recipe and likes to cook.



## Debt Financing – Required Documents

Before you walk into a bank to request financing, BE PREPARED. Your thorough preparation in advance of a loan request may not result in a loan, but it will make the loan officer more receptive to your inquiry.

### Documents required:

- Business plan
- 3 year detailed (monthly) financial forecast
- 3 years personal tax returns
- 3 years financial statements (if existing business)
- Articles of incorporation
- Legal documents for any contracts, franchise agreement, lease agreement, etc.
- Personal financial statement
- Personal credit report (bank may pull this)

<https://www.sba.gov/content/business-loan-checklist>



## Grants

- Grant funds are almost never available to fund the general expenses of a start-up business:
  - <https://www.sba.gov/blogs/government-grants-small-business-think-you-qualify>
- Federal research grant programs:
  - SBIR, STTR
- Local government grants
  - ETIP (State) training grants.
  - SBIF (Small Business Improvement Fund) – uses TIF revenues to help owners of commercial or industrial properties repair or remodel their facilities.
  - City grants: façade and other special subsidy programs.
  - Grant “contests”.



## Other Financing Considerations

- Crowdfunding
  - Examples: Kickstarter, IndieGoGo
  - The Crowdfunding company provides the platform for you to hold your funding campaign, and handles the collection and transfer of monies.
  - YOU are responsible for developing a social network and promotional materials to entice your followers to back you financially.
  - The SEC does not currently permit Crowdfunder to take an equity position in your company.
- Predatory lenders
  - The current tight credit market has resulted in a growing number of predatory lenders and merchant cash advance providers who offer quick access to cash, but charge exorbitant interest rates.
  - Beware of funding that seems “too good to be true”.
  - Do your homework before signing for a loan.
  - <http://us.accion.org/business-resources/articles-videos/what-predatory-lending>



## Business Cost Terminology

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Numbers are behind all smart strategic and tactical business decisions!

### Start-up costs (Project cost)

- All the one-time expenditures needed to open the business.

### Working capital

- Cash on hand available to pay ongoing business expenses.

### Cost of Goods Sold (COGS) (a.k.a. Direct or Variable costs)

- Expenses that are directly related to generating a sale of product or services.
- Examples: Food costs for a restaurant; contract or hourly labor; inventory for a retail store.

### Fixed costs (a.k.a. Indirect or G&A costs)

- Expenses that occur regardless of sales made.
- Examples: rent, marketing, utilities, Administrative payroll.

Gross Profit – the money made from a sale after Cost of Goods Sold.

Net Profit (Loss) – the amount of money made (or lost) after all business expenses are paid.



## Three Basic Truths

1. You don't need a degree in finance to understand financial statements.
2. Your business will be stronger if you make management decisions based on your financial data.
3. Garbage in, Garbage out – if you aren't keeping an accurate, complete accounting of your business transactions, then you will have a difficult time managing and growing your business.

# Financial Statements

- Balance Sheet
  - Transactions related to assets and liabilities.
  - Net value of the business.
  - At that moment in time.
- Profit & Loss or Income Statement
  - Transactions related to revenue and expenses.
  - Profitability of the business.
  - Over a period of time.
- Cash Flow Statement
  - Money in and out of the business.



<b>ASSETS (WHAT YOU OWN)</b>	
<b>Current Assets (converts to cash in one year)</b>	
Cash .....	10,000
Accounts Receivable .....	75,000
Inventories .....	85,000
<b>Total Current Assets (10K+75K+85K) .....</b>	<b>170,000</b>
<b>Non-Current Assets (more than one year to convert to cash)</b>	
Fixed Assets (furniture, fixtures, property, equipment) .....	140,000
Less Accumulated Depreciation .....	- 25,000
Fixed Assets (net, 140K - 25K) .....	115,000
Advances to Owners .....	6,000
<b>Total Non-Current Assets (115K + 6K) .....</b>	<b>121,000</b>
<b>Total Assets (170K + 121K) .....</b>	<b>291,000</b>
<b>LIABILITIES (WHAT YOU OWE)</b>	
<b>Current Liabilities (due within one year)</b>	
Accounts Payable .....	41,000
Accrued Taxes .....	3,000
Current Portion of Long-Term Debt .....	6,000
Note Payable (due within one year) .....	100,000
<b>Total Current Liabilities .....</b>	<b>150,000</b>
<b>Long-Term Liabilities (due for more than one year)</b>	
Loan Payable .....	54,000
<b>Total Long Term Liabilities .....</b>	<b>54,000</b>
<b>Total Liabilities (150K + 54K) .....</b>	<b>204,000</b>
<b>CAPITAL OR NET WORTH (THE COMPANY'S EQUITY)</b>	
Owners Investment .....	20,000
Retained Earnings (income kept in the business) .....	67,000
<b>Total Capital or Net Worth (67K + 20K) .....</b>	<b>87,000</b>
<b>Total Liabilities &amp; Capital (204K + 87K) .....</b>	<b>291,000</b>

## BALANCE SHEET

### Assets (Own)

- Current assets
- Non-current assets
- Fixed assets
  - (less depreciation)

### Liabilities (Owe)

- Current liabilities
- Long term liabilities
- Fixed assets
  - (less depreciation)

### Net Worth

- Owner Investment
- Retained Earnings

**Max Computer Company, Income Statement**

Net Sales	.....	900,000	100%	
Less Cost of Goods Sold (cost to make products):				
Beginning Inventory	.....	75,000	8%	
Purchases (to make product)	.....	350,000	39%	
Labor (to make product only)	.....	200,000	22%	
Total (75K+350K+200K)	.....	625,000	69%	
Less: Ending Inventory	.....	- 85,000	9%	
Cost of Goods Sold (625K less 85K)	.....	540,000	60%	
Gross Profit (900K less 540K)	.....	360,000	40%	
Operating Expenses:				
→ Selling Expenses	.....	90,000	10%	
General and Administrative	.....	+ 170,000	19%	←
Total Expenses (90K + 170K)	.....	260,000	29%	
Operating Income (360K less 260K)	.....	100,000	11%	
Less: Interest Expense (on loans)	.....	- 20,000	2%	
Net Profit before taxes (100K less 20K)	.....	80,000	9%	
Less: All Income Taxes	.....	- 27,000	3%	
Net Profit (80K less 27K)	.....	53,000	6%	

**INCOME STATEMENT (P&L)**

**Revenue (Sales)**

- Less returns/allowances

**Cost of Goods Sold**

- Expenses related directly to generating sales
- Variable

**Gross Profit (Margin)**

**Fixed (Operating) Expenses**

- a.k.a. overhead
- Fixed (or increase in step fashion)

**Net Profit**

- Added to Retained Earnings on the Balance Sheet

*Percentages are used to benchmark and compare performance to prior periods.*

	Jan	Feb	Mar	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Total
<b>A. Cash On Hand</b> (Beginning of month)	10,000	5,627	13,741	10,470	13,830	15,190	11,498	15,202	22,157	30,997	39,372	48,601	
<b>B. Cash Receipts</b>													
1. Cash Sales													
2. Collections from Credit Accounts	32,813	75,000	76,250	81,250	85,000	85,750	88,500	90,000	88,750	84,250	81,500	78,750	
3. Loan or Other Cash Injection (specify)													
<b>C. Total Cash Receipts</b> (B1+B2+B3)	32,813	75,000	76,250	81,250	85,000	85,750	88,500	90,000	88,750	84,250	81,500	78,750	
<b>D. Total Cash Available</b> (A+C, before cash paid)	42,813	80,627	89,991	91,720	98,830	100,940	99,998	105,202	110,907	115,247	120,872	127,351	
<b>E. Cash Paid Out:</b>													
1. Purchases (Merchandise)	0	30,000	42,500	42,500	44,000	45,000	45,000	42,500	41,000	40,000	37,500	37,500	447,500
2. Gross Wages (excludes withdrawals)	10,758	10,758	11,364	11,970	11,970	12,334	12,576	12,576	11,970	11,606	11,364	10,758	140,004
3. Payroll Expenses (Taxes, etc.)	1,076	1,076	1,136	1,197	1,197	1,233	1,258	1,258	1,197	1,161	1,136	1,076	14,001
4. Outside Services	758	758	808	859	859	889	909	909	859	828	808	758	10,002
5. Supplies (Office and operating)	383	383	408	434	434	449	459	459	434	418	408	303	4,972
6. Repairs and maintenance	390	390	416	422	422	458	468	468	442	426	416	390	5,108
7. Advertising	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	4,200	50,400
8. Car, Delivery and Travel	2,700	2,700	2,800	2,900	2,900	2,960	3,000	3,000	2,900	2,840	2,800	2,700	34,200
9. Professional Services (Accounting, legal, etc.)	1,500	0	0	1,500	0	0	0	0	0	1,500	0	0	4,500
10. Rent	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	1,950	23,400
11. Telephone	278	278	296	315	315	326	333	333	315	303	296	278	3,666
12. Utilities	400	400	400	400	400	400	400	400	400	400	400	400	4,800
13. Insurance	0	450	450	450	450	450	450	450	450	450	450	0	4,500
14. Taxes (real estate, etc.)	0	750	0	0	750	0	0	750	0	0	750	0	3,000
15. Interest (on loans)	500	498	495	493	490	488	485	482	480	477	475	472	5,835
16. Other/Miscellaneous Expenses (specify)	0	0	0	0	0	0	0	0	0	0	0	0	0
<b>17. Subtotal</b>	24,893	54,591	67,223	69,590	70,337	71,137	71,488	69,735	66,597	66,559	62,953	60,785	755,888
<b>F. Other Operating Costs:</b>													
1. Loan Principal Payment	293	295	298	300	303	305	308	310	313	316	318	321	3,359
2. Capital Purchases (ex., Buy a computer)	0	0	0	0	0	5,000	0	0	0	0	0	0	5,000
3. Other Start-up Costs	0	0	0	0	0	0	0	0	0	0	0	0	0
4. Reserve and/or Escrow (ex., Pay \$100K loan)	10,000	10,000	10,000	5,000	10,000	10,000	10,000	10,000	10,000	5,000	5,000	5,000	100,000
5. Owner's Withdrawal	2,000	2,000	2,000	3,000	3,000	3,000	3,000	3,000	3,000	4,000	4,000	4,000	36,000
<b>G. Total Cash Paid Out</b> (E17 + F1 through F5)	37,186	66,886	79,521	77,890	83,640	89,442	84,796	83,045	79,910	75,875	72,271	70,106	
<b>H. Cash Position</b> (End of month, D minus G)	5,627	13,741	10,470	13,830	15,190	11,498	15,202	22,157	30,997	39,372	48,601	57,245	
<b>I. Essential Operating Data</b> (Non-cash flow info)													
1. Accounts Receivable (End of month)	117,188	117,188	120,938	124,688	124,688	126,938	128,438	128,438	124,688	122,438	120,938	117,188	
2. Bad Debt (End of month, if applicable)	0	0	0	0	0	0	0	0	0	0	0	0	
3. Inventory on Hand (End of month)	77,500	82,500	85,000	86,500	89,000	90,000	87,500	83,500	81,000	77,500	75,000	75,000	
4. Accounts Payable (End of month)	71,000	83,500	83,500	85,000	86,000	86,000	83,500	82,000	81,000	78,500	78,500	78,500	

**CASH FLOW STATEMENT**

**Planning for:**

- Seasonality
- Periodic or one-time expenses
- Debt servicing

**A business can be profitable and still fail if they don't manage cash flow!**





## Next Steps

- Meet with a Small Business Development Center (SBDC), SCORE volunteer, Business Services Team (BST) or other mentor regularly to help you evaluate your business idea, prepare a business plan, explore regulatory requirements, and understand financing options.
  - Services are free
  - Advisors have business expertise
- Talk to other business owners to learn what they would have done differently.
- Take classes and learn fundamental business skills that can be put to use in the business.
  - <https://www.illinois.gov/dceo/SmallBizAssistance/BeginHere/Pages/SBDC.aspx>
  - <https://www.score.org/chapters-map>
  - <https://www2.illinoisworknet.com/Connect/Pages/LocationSearch.aspx> - Search for Partners Serving Employers



## And more...

- Develop a complete business plan, including a detailed financial forecast, to make sure that your concept will be profitable, and to identify all costs involved.
- Don't rush, and don't skip steps! If the pieces of your plan don't seem to be coming together, keep working the plan, or put it aside for a while until the time is right. Starting a business is a big decision and a major commitment.
- Don't sign contracts or make other commitments until you are completely ready, and financing has been finalized.
- Even if you don't move forward with your idea, don't be discouraged. What you have learned will be valuable in the future.



Sponsored by the Illinois Department of Commerce and Economic Opportunity (DCEO)

## Questions



## Harriet Parker, Manager Small Business Development Center Waubonsee Community College

Thanks to Harriet Parker for sharing her expertise!

