Business Financing

Tax and Business Update

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Short-Term Financing	
Demand notes and funds due in less than one year	
Maintenance Contracts	Contract with a customer in which the company guarantees service for a specified period in return for a set fee paid in advance. **Caution:** Business is committed to providing maintenance and repair services that may cost more than the revenue generated.
Lines of Credit	Agreement with a bank to borrow up to a specified amount whenever needed, with interest paid only on amount actually borrowed. To obtain a line of credit, business ordinarily must pledge certain assets as collateral, generally including accounts receivable, inventory and any other short-term assets. However, some banks charge commitment fees (generally from ¼% to ½% of the total line of credit) and may impose additional charges for undrawn funds.
Demand Notes	Note has no fixed term; is callable by lender. May be unsecured or secured by owner's personal assets.
Receivables Financing	Accelerates future collections. May take the form of (1) advances against accounts receivable, (2) factoring or (3) credit cards.
Inventory Financing	Loans collateralized by specific items of inventory or inventory in total. Lenders usually provide less money for inventory than for an equal value of receivables.
Construction Loans	Loan funds are drawn as construction of commercial property progresses and repaid from proceeds of permanent financing (normally a long-term mortgage loan) obtained when project is completed.
Asset-Based Lending	Asset-based lenders will make loans to companies that are highly leveraged or lack strong cash flow, and may accept collateral that is not attractive to banks. *Advantage:* typically no compensating balance requirements or extensive loan covenants. *Disadvantages:* lender charges higher interest rates and maintains tighter controls over collateral.
Letters of Credit	Used to finance overseas purchases. A bank issues a letter of credit promising to pay a third party a specified amount (for example, vendor invoices). The bank customer pays a deposit for the letter or the amount is added to an existing line of credit.

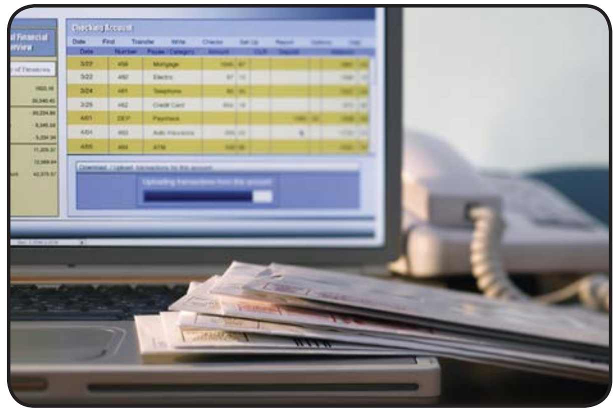
Medium-Term Financing	
One to five years; may be secured or unsecured	
Equipment Financing	Manufacturers and suppliers of machinery, equipment and vehicles often provide financing for buyers.
Leasing Arrangements	A popular way to obtain business equipment. *Advantages:* (1) small down payment, (2) generally is less restrictive than a debt agreement and (3) provides some protection against obsolescence because the business may return the equipment at the end of the lease term. *Disadvantage:* the business does not own the asset at the end of the lease term, although the equipment can often be purchased for a nominal amount.
Sales and Leasebacks	Fully depreciated equipment in good condition may be sold to another party and leased back. The seller (borrower) obtains cash and retains use of the equipment. Since the purchaser (lender) can depreciate the equipment while generating lease income, the cost to the borrower may be lower than a loan.
Term Loans	Loans of 1–10 years secured by specific machinery and equipment with fixed or variable interest rates, depending on the bank. Most banks will normally advance 70% to 95% of the FMV of new machinery or equipment and 50% to 80% of the quick sale value of used machinery or equipment.
Government Loan Programs	U.S. Small Business Administration (*www.sba.gov*), National Science Foundation (*www.nsf.gov*) and Departments of Energy (*www.doe.gov*), Housing and Urban Development (*www.hud.gov*), Interior (*www.doi.gov*), Commerce (*www.commerce.gov*) and Agriculture (*www.usda.gov*). In addition, some state and local agencies provide financing.

Long-Term Financing

Difficult to obtain except for mortgage loans	
Equity Financing	Potential sources include private investors, other companies and employees of the business who want to participate in its growth. *Advantages:* generally cheaper than debt because there is no interest cost; does not have to be repaid. *Disadvantages:* dilutes the existing owner's holdings; the new shareholders may insist on participating in management, which could cause conflicts.
Venture Capital	Venture capitalists typically invest $500,000 or more in a company expecting that in three to five years it will be worth considerably more.
Angel Investors	Venture capitalists who invest in companies with promising but unproven ideas. They typically invest between $25,000 and $500,000 in business start-ups; may demand a lower return on their investment and be willing to invest for longer periods.
Mortgage Loans	Mortgage loans may be made based on the value of the property financed or on a combination of the value of the property and the income stream expected over the life of the mortgage. Some lenders provide mortgage loans with terms of 20 to 25 years and fixed interest rates, although variable rates are common. Insurance companies and pension funds also provide mortgage financing.
Layered Financing	Uses several financing sources at one time; should be considered if a single source fails to meet the business's needs. May be attractive to potential financing sources because it allows them to share financing risks. However, it can be time-consuming and complex since the business is pursuing multiple financing sources with differing requirements at the same time.

Private Sources

The easiest to obtain and usually the lowest cost	
Personal Resources	Loans or equity contributions from the owner's personal resources. *Advantage:* obtain more quickly than other sources. *Disadvantage:* lose availability of funds for future personal use.
Friends or Relatives	May take the form of debt, equity or a hybrid debt with an option to convert to equity. *Advantage:* often available at a lower cost of capital due to the relationship between the parties. *Disadvantages:* may result in inadequate financing or financing at terms that inhibit the ability of the business to operate or grow; may lead to later friction between the parties.
Vendor Credit	Vendors tend to relax their credit constraints as the company begins operation.
Customer Deposits	Customer prepayment funds the working capital needed to manufacture or provide the product or service the customer will ultimately receive.



Notes

The handout is designed to provide accurate information regarding the subject matter covered. However, before completing any significant transactions based on the information contained herein, please contact us for advice on how the information applies in your specific situation.

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