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Financing the Start-Up or expansion of a U.S. Business

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There are generally two ways to raise capital for the start-up or expansion of a U.S. business, either by debt financing or equity financing. Debt financing involves a loan wherein the borrower must pay the lender the principal amount of the loan plus interest, and equity financing involves selling equity interests in the business to investors in exchange for the injection of capital into the business.

Key factors to consider in determining the best financing option are the size of the business, the nature of the business, the market opportunity being targeted, the potential for substantial growth of the business, and the costs related to financing. In the case of a small business, typically the founders desire to maintain full control of the business and therefore do not want to grant an equity interest to an investor to fund or partially fund the start-up or expansion of their business. On the other hand, if the founders predict that their business will be a high growth business such that it will likely go public in the future, then, if not initially, the founders will in most cases ultimately rely on equity financing, including in some cases financing from venture capitalists. Typically, equity financing is more expensive than debt financing.

Venture capitalist firms can be instrumental in the success of a start-up business, not only by providing the required capital, but also due to their expertise in providing strategic assistance such as introducing key partners, employees, and customers to the business, as well as facilitating strategic alliances. However, such financing arrangements are not easy to obtain, since venture capitalists are very selective in their investments, focusing on criteria such as certain specific industry sectors, the stage of the start-up company (i.e., is it in its early stage seed round, at a point where it has shown progress in building its business model and demonstrating its potential to grow and generate revenue, or at a later stage where the company has achieved meaningful revenues and traction). Venture capitalists will typically want to invest in start-ups that have already shown some meaningful traction, such as by having working product prototypes, early customer adoption, or significant revenue.

In the case of the start-up of a business by foreign founders, in addition to the required business and estate planning, proper pre-planning must be implemented to lay the groundwork for potential debt financing. By planning in advance and taking steps such as opening a U.S. bank account or financing the purchase of a home or an automobile in the U.S., the individual founders can establish their credit and increase their ability to obtain a loan from a bank for the start-up of their business. If the foreign founders have not established credit in the U.S., they might not be able to qualify for a loan on favorable terms, and their options may be limited to obtaining a small loan at a high interest rate or a small business credit card at a high interest rate. In such cases, better options should be explored such as the founders using more of their available cash reserves to fund, at least in part, the start-up of their business, or using U.S. real estate or other assets in the U.S. as collateral for a loan on more favorable terms.

A specific debt financing option that founders starting up a small business might consider is a Small Business Administration (SBA) loan, in amounts ranging from $30,000.00 to $5,000,000.00. Although the requirements are strict and the approval process is time consuming, SBA loans are specifically designed for small businesses to succeed and thus are more flexible on aspects such as the required borrower's equity investment, making funds available for working capital, and the length of time allowed for repayment of the loan. An SBA microloan is another debt financing option for small business founders. The microloan program offers short term loans of up to $50,000.00 in working capital that can be used to start or grow a business.

SBA loans are available for small businesses owned by U.S. citizens and legal permanent residents, as well as by non-residents. According to the SBA, financing is available for businesses that are 51% owned and controlled by non-citizens, provided that such persons are lawfully in the U.S. However, each lender has the discretion to determine whether or not to lend to a non-citizen.

In the case of a business which requires the special expertise of an individual in order for the business to succeed, one equity financing option is for the founders to invite such an individual to be an equity owner of the business in exchange for the in-kind contribution of the individual's special expertise. For this option, proper planning of the structure of the capital contributions from each investor should be done. Depending on the income tax impact to the individual contributing the services, perhaps a combination of capital contributions and loans from the principal founders would be an appropriate strategy.

If targeted debt financing is not available to founders starting up a small business who prefer debt financing, even though equity financing may not be their first choice, certain possibly viable equity financing options should be explored. One such equity financing option is to seek out high net worth individuals, referred to as angel investors, who are willing to fund small start-ups in exchange for equity ownership. Such potential investors could be family or friends, keeping in mind that leads for such investors can be obtained from others such as entrepreneurs, accountants, attorneys, angel investor networks, or venture capitalists.

In the case of U.S. companies, whether large or small, that already have an established business and desire to expand their operations, more options are available for the financing of such expansion such as accounts receivable financing, working capital loans, small business term loans, and equipment loans.

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