CAFE
Community Assistance Friends Enterprise

INFORMATIONAL SUMMARY

Raising Capital for your Small Business

The ability to raise adequate capital (money) for your business is a make it or break it step for a small business's success. Unfortunately, it is often an area that many first-time business owners struggle with because of a lack of familiarity with the fundraising options.

Stage 1 – Starting a Business

Initial Investment
Before starting your small business, it is critical that you take stock of all the resources that you have and can contribute to the business as well as what you anticipate needing. Below are examples of sources of startup money and resources: • Money - personal checking and savings accounts or retirement accounts • Existing equipment that could be useful for the business (car, computer, etc.) • Available personal credit from existing or new credit cards or personal loans • Equity in your home that could be accessed through a second mortgage or line of credit • Potential partner's resources - share your idea and form your business with a partner

Note: You should document any money or resources contributed to the business (and who contributed it) upon founding. This is important because it can form the basis of owner equity (which is helpful for valuation purposes) and useful for tax purposes, or in the case of a dispute between founders.

Stage 2 – Raising Funds to Operate your Business

Option A: Friends and Family
Friends and family may be the most important sources of early fundraising available to your small business. However, they have limited resources and you would be relying on your good relationship with them to convince them to provide you with money or resources. To move into this stage, you should have already formed your business and have a clear business plan and strategy. Below are examples of how to legally raise money from friends and family: • Gifts – The federal gift free tax limit (PA has no gift tax) per recipient per year is $15,000 so friends and family can give any amount up to $15,000 without paying taxes on it; • Pre-selling – You can pre-sell services or goods as long as the service or good is sold at the fair market value; • Private loans – friends and family may be willing to lend you money and take on significant risk because of their faith in you. However, these loans should be well documented and structured as loans not gifts, securities, or guaranteed returns; and or • Securities – Many people attempt to sell equity in their business to friends and family. However, this runs into securities and exchange commission laws and regulations. To legally issue a security or sell equity in a company you must register the sale or fit into a registration exception. For more information read our informational summary on securities or visit the SEC website.

Note: You should document in writing the terms of any deals with friends and family for both parties protection. For example, loans should be documented with the interest rate, payment schedule, term of the loan, and any other terms written out and signed by both parties. If you receive a gift you should ensure you send a thank you note to document that it was a gift not a loan.

Option B: Crowdfunding
Crowdfunding has become a revolutionary tool for small businesses allowing for significant capital raises spread across many individuals as well as increasing brand exposure. Crowdfunding can be a great way to reach out into your community beyond friends and family. Potentially, crowdfunding may be the first time your business is raising capital from people you do not personally know. There are two basic types of crowdfunding: 1. Peer-to-Peer crowdfunding where a business sets a campaign goal, states what the funds will be used for, and receives money from contributors (gifts). This type of crowdfunding also may involve pre-sales where contributors are rewarded with exclusive products. Additionally, some platforms only allow businesses to receive funds, if the fundraising goal is met. Platforms will charge a percentage fee on all contributions. Examples of this type of crowdfunding site include IndieGoGo, Kickstarter, and GoFundMe among others; 2. Equity Crowdfunding where a company uses the Regulation Crowdfunding SEC exception to offer securities worth up to $1,070,000 in a 12-month period. This is designed for more established ventures who already have revenue or are somewhat established. Examples of Equity Crowdfunding platforms include AngelList, CircleUp, and SeedInvest among others.

Stage 3 – Expansion / Long Term Funding

Bank Financing
Ultimately, for many small businesses a bank will be your main source of additional capital. There are numerous different financial products offered by banks that are available at different stages of a business' development. Below is a list of some of the different services offered by traditional banks: 1. Bank Account (and Debit Card) – Any small business will need some form of bank account for depositing revenues or processing credit cards. A business bank account can be opened as soon as your business is setup; 2. Credit Card – If the businesses owner has sufficient credit and the business has at least a brief operating history, many businesses can qualify to open a credit card account; 3. Line of Credit – For more established businesses that have an operating history, it is possible to open a revolving line of credit. Lines of credit function like credit cards where a business can fund purchases by spending against the line of credit and paying interest on the amount that remains unpaid at the end of a payment term. This is useful for businesses that need more working capital to operate smoothly or need to make large purchases that cannot be collateralized (or borrowed against directly); 4. Bank Loans and Term Loans – Most banks will require a personal guarantee or additional collateral for a large loan. However, a business with an extensive operating history may qualify for a loan on the strength of the business itself. This type of loan may be useful for financing an expansion, such as a new location or the purchase of real estate among other things.

Note: qualifying for and receiving a bank loan will require a rigorous "due diligence" period where the bank will investigate the business to ensure that you are on the up and up. During this process it is crucial that you are able to identify the terms of any prior loans or equity agreements. Indeed, you may need to move a friend or family member into a less secured position to close the deal. Alternatively, this might be a prime opportunity to cash out some of your early investors.

For additional information about the specifics of any of these fundraising methods or strategies or advice specific to your individual business please reach out to CAFE through our Intake Form.