

## **Glossary of Select Financing Terms**

**Acquisition:** Acquisition is the process through which one company takes over the controlling interest of another company. Acquisition includes obtaining supplies or services by contract or purchase order with appropriated or non-appropriated funds, for the use of Federal agencies through purchase or lease.

**Angel Investor:** Angel or Angel Investor is an individual who provides capital to one or more startup companies. Unlike a partner, the angel investor is rarely involved in management. Angel investors can usually add value through their contacts and expertise.

**Asset Based Lending:** Asset-based lending is any kind of lending secured by an asset. This means, if the loan is not repaid, the asset is taken. In this sense, a mortgage is an example of an asset-backed loan. The phrase is used more commonly to describe lending to business and large corporations using assets not normally used in other loans. Typically, these loans are tied to inventory, accounts receivable, machinery and equipment. This type of lending is usually done when the normal routes of raising funds, such as the capital markets (selling bonds to investors) or normal unsecured or mortgage secured bank lending is not possible. This is usually because the company couldn't raise capital in the normal marketplace or needs more immediate capital for project financing needs (e.g. inventory purchases, mergers, acquisitions, debt purchasing). It is usually accompanied by higher interest rates, and can be very lucrative for the parent company.

**Entrepreneur:** An entrepreneur is an owner or manager of a business enterprise who makes money through risk and initiative.

**Equipment Leasing:** Obtaining the use of machinery, vehicles or other equipment on a rental basis. This avoids the need to invest capital in equipment. Ownership rests in the hands of the financial institution or leasing company, while the business has the actual use of it.

**Factoring:** Factoring is a financial transaction whereby a business job sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount. In "advance" factoring, the factor provides financing to the seller of the accounts in the form of a cash "advance," often 70-85% of the purchase price of the accounts, with the balance of the purchase price being paid, net of the factor's discount fee (commission) and other charges, upon collection. In "maturity" factoring, the factor makes no advance on the purchased accounts; rather, the purchase price is paid on or about the average maturity date of the accounts being purchased in the batch. Factoring differs from a bank loan in several ways. The emphasis is on the value of the receivables (essentially a financial asset), whereas a bank focuses more on the value of the borrower's total assets, and often considers, in underwriting the loan, the value attributable to non-accounts collateral owned by the borrower also, such as inventory, equipment, and real property.<sup>[1][2]</sup> i.e., matters beyond the credit worthiness of the firm's accounts receivables and of the account debtors (obligors) thereon. Secondly, factoring is not a loan – it is the purchase of a financial asset (the receivable). Third, a nonrecourse factor assumes the "credit risk," that a purchased account will not collect due solely to the financial inability of account debtor to pay. In the United States, if the factor does not assume credit risk on the purchased accounts, in most cases a court will recharacterize the transaction as a secured loan.

**Initial Public Offering or IPO:** Initial Public Offering or IPO is the first sale of stock by a private company to the public. IPOs are often smaller, younger companies seeking capital to expand their business.

**Leveraged Buy-Out or LBO:** Leveraged Buy-out or LBO is an acquisition of a business using mostly debt and a small amount of equity. The debt is secured by the assets of the business. In LBO, the acquiring company uses its own assets as collateral for the loan in hopes that the future cash flows will cover the loan payments.

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**Management Buy-Out or MBO:** Management Buy-out or MBO is the term used for the funds provided to enable operating management to acquire a product line or business, which may be at any stage of development, from either a public or private company.

**Mezzanine Financing:** Mezzanine Financing is a late-stage venture capital, usually the final round of financing prior to an IPO. Mezzanine Financing is for a company expecting to go public usually within 6 to 12 months, usually so structured to be repaid from proceeds of a public offerings, or to establish floor price for public offer.

**Small Business Investment Companies or SBIC:** Small Business Investment Companies or SBIC are lending and investment firms that are licensed and regulated by the Small Business Administration. The licensing enables them to borrow from the federal government to supplement the private funds of their investors. SBICs prefer investments ranging from \$100,000 to \$250,000 and have much more generous underwriting guidelines than a venture capital firm.

**Strategic Partnership:** A strategic partnership is a formal alliance between two commercial enterprises, usually formalized by one or more business contracts but falls short of forming a legal partnership or, agency, or corporate affiliate relationship. Typically two companies form a strategic partnership when each possesses one or more business assets that will help the other, but that each respective other does not wish to develop internally.

**Trade Credit:** Trade credit is an arrangement between businesses to buy goods or services on account, that is, without making immediate cash payment. The supplier typically provides the customer with an agreement to bill them later, stipulating a fixed number of days or other date by which the customer should pay. It can be viewed as an essential element of capitalization in an operating business because it can reduce the capital investment required to operate the business if it is managed properly. Trade credit is the largest use of capital for a majority of business to business (B2B) sellers in the United States and is a critical source of capital for a majority of all businesses.

**Venture Capital:** Venture capital (VC) is financial capital provided to early-stage, high-potential, high risk, growth startup companies. The venture capital fund makes money by owning equity in the companies it invests in, which usually have a novel technology or business model in high technology industries, such as biotechnology, IT, software, etc. The typical venture capital investment occurs after the seed funding round as growth funding round (also referred to as Series A round) in the interest of generating a return through an eventual realization event, such as an IPO or trade sale of the company. Venture capital is a subset of private equity. Therefore, all venture capital is private equity, but not all private equity is venture capital.

## **Recommended Reading**

- Willam A. Sahlman, "How to Write a Business Plan." Harvard Business Review, July-August, 1997
- Amar Bhidé, "Bootstrap Finance: The Art of Startups." Harvard Business Review, November-December, 1992
- David Cohen, Brad Feld, *Do More Faster*
- Brad Feld, Jason Mendelson, *Venture Deals*
- Guy Kawasaki, *The Art of The Start*
- Walter Isaacson, *Steve Jobs*

# Sources of Financing by Stage



	Development	Start-up	Early Growth	Rapid Growth	Exit
Entrepreneur					
Friends and Family					
Angel Investors					
Strategic Partner					
Venture Capital					
Asset-based Lender					
Equipment Lessor					
SBIC					
Trade Credit					
Factor					
Mezzanine Lender					
Public Debt					
IPO					
Acquisition, LBO, MBO					








Black shading indicates primary focus of investor type. Gray shading indicates secondary focus, or focus of a subset of investors of the type.

# FUN WITH FUNDING

## YOUR STARTUP FINANCING OPTIONS EXPLAINED

Starting a business is hard work; intelligently choosing the right funding for you shouldn't be. Not all funding works the same, and you should carefully consider the pros and cons of each before pursuing any of them.

Key: LOW MODERATE HIGH

Funding Type	Average Investment Size	Difficulty to Obtain	Flexibility	Risk
 <b>Venture Capital</b>	Around \$8 million, though some investments can be much higher.	Venture capitalists are very selective. In the first quarter of 2011, they only funded 738 deals.	Venture capitalists seek a substantial equity (20-30% avg.) and a seat on the company's board of directors. It can be difficult to make decisions that the VC doesn't agree with.	Venture capitalists are not loaning you money; they are buying a piece of your business. If the business fails, their investment is sunk with it.
 <b>Seed Investment</b>	Less than \$20,000. Seed funds invest the smallest amount of money necessary to get a company started.	Seed funding is granted by special investment firms, or by venture capitalists. Both are very selective.	Because the investment amount is so small, seed investors typically only get a small percentage of the company (around 6%).	Like the venture capitalist, seed investors buy a piece of your company. This is not a loan, so there is no obligation to repay if the business fails.
 <b>Angel Investment</b>	Around \$37,000, but can be higher depending on the individual investor.	Angels typically accept 3 out of 10 proposals they receive. Acceptance is about selling your idea to an individual rather than an entire firm.	Angels create unique deals for each investment they make. Some take a large stake in the business, while others are happy to collect a dividend and stay out of the way.	The risk of accepting angel investment depends on the investor's intentions. Read the proposal carefully and see what, if anything, you will be on the hook for if the business fails.
 <b>Crowdfunding</b>	Around \$2,000 - \$10,000. The money is raised from people looking to donate to a small, specific project.	About 1/2 of small projects are accepted, and 1/2 of those meet their funding requirement.	Donors do not retain ownership interest in the resulting work.	The money is pledged as a donation. If the project goes under or never grows into a business, there is no obligation to repay the donors.
 <b>Bank Loans</b>	The size of a business loan depends on current revenue and projected company growth.	Lenders typically want to see positive business revenue and good personal credit before signing a check.	A lender does not have any say in how you spend the money. Business decisions are yours to make.	When you take out a loan for a business, you are personally responsible for paying it back. If the business tanks, you still owe the debt.
 <b>Business Credit</b>	The size of a business credit line depends on the revenue and creditworthiness of the borrower.	Acquiring business credit requires a solid credit history from the company and/or borrower.	Unlike a loan, a line of credit can be used again and again—provided you can pay off the balance each month.	Credit is essentially the same as a loan. If the business goes under, your debt will still be owed.
 <b>Grants</b>	Grants vary greatly in size, ranging from a few hundred dollars to \$100,000+.	There are a great number of grants available for many different goals. Chances are, you can qualify for one.	Grant issuers are not involved in the decision-making of your company.	Grants are given without obligation to repay.