



## Startup Financing During the Credit Crunch

Creativity goes a long way when it comes to financing your startup during tough economic times.

By Asheesh Advani | February 28, 2008

The credit crunch that began with mortgages has now spread to consumer loans and small business financing. Banks have tightened their lending criteria and business owners will need to look elsewhere for financing. This shouldn't be a surprise to readers of this column because I've often complained that banks tend to ignore startups even during normal market circumstance. The credit crunch has resulted in rising defaults for revolving credit in addition to mortgages; this could translate into higher fees and tougher underwriting standards if you plan to finance your business with credit card debt or home equity lines of credit. It's time to look for alternatives.

### **Borrow from yourself**

I've never supported the notion that entrepreneurs should borrow from their 401(k)s or retirement assets to finance a startup, but in these difficult times, it's worth considering how to best use your savings to fund your business. Typically, business owners rely on their savings for about 30 percent of initial startup funding. Rather than taking this money from your retirement assets, consider liquidating some appreciated stock and lending it to your company. Lending the money to your company is better than purchasing equity in your company because you can pay yourself back at a later date if you've documented the loan properly. You should already have enough founder's stock. For amounts as low as \$15,000, it's perfectly reasonable to use proceeds from future revenues or even future investors in your business to pay yourself back.

### **Borrow from your family and friends**

Loans from family and friends are the time-honored way to finance startups. These loans are typically cheaper and more "patient" than other forms of capital. Your parents might give you a

no-interest loan. Your friends and business associates might give you a rate that is slightly higher than they are earning in their high-yield savings account. On average, private business loans from relatives and friends have interest rates 2 to 3 percent lower than market rates and 1 to 2 percent higher than high-yield savings rates. If you're like most entrepreneurs, you would prefer to take the money in the form of equity rather than debt. Resist the temptation unless you are certain that your startup's equity will one day provide your relatives and friends with a return.

Keep in mind that you can arrange to have the same patient repayment feature of equity by creating a long-term grace period on debt. For example, arrange to borrow money with a three-year grace period and create bonus payments paid to your friendly lender if you reach certain business milestones. This allows the loan to feel much more like an equity investment, but it avoids the problem of adding your relatives and friends into your equity capital structure. I have often seen cases in which entrepreneurs are unable to repay relatives because they subsequently raise money from professional investors who do not look kindly on business owners who try to repay one class of equity investors before others.

### **Borrow from strangers online**

Many person-to-person loan websites now allow borrowers to get money from strangers online. Typing "person to person loan" into a search engine will lead you to several online loan companies that enable borrowers to ask for funds and enable individual lenders to earn a good return for making private loans online. Although interest rates tend to be higher, these sites are a great resource for entrepreneurs seeking funds during the credit crunch.

### **Borrow from the SBA**

Funding for SBA loan programs does not appear to be on the chopping block in this year's budget. Therefore, banks will continue to make loans that are guaranteed by the SBA and the underwriting standards for these loans should not be radically altered by the credit crisis. Check my previous column for more information on applying for SBA loans.

*Asheesh Advani is Entrepreneur.com's "Startup Financing" columnist and CEO of Virgin Money USA. He founded CircleLending, which pioneered the business of managing person-to-person loans and mortgages, and is now part of the Virgin Group. [Click here](#) to get a copy of Virgin Money's free Small Business Financing Guide.*