

Navigating Funding Options: A Beginner's Guide to Debt, Equity, and Legal Considerations

❖ **Introduction**

- Raising capital is essential for anyone looking to start or grow their business. This includes: microentrepreneurs, small business owners, startups, and established businesses.

❖ **Types of Capital**

- **Ways to raise capital:** personal savings, family and friends, loans and credit, investors, grants, crowdfunding, partnerships
- **Types of financing:**
 - **Debt Financing:** borrowing money that must be repaid with interest
 - **Equity Financing:** selling a portion of ownership in your business in exchange for capital
- **Requirements Needed to Obtain Financing:**
 - Business plan
 - Financial statements
 - Capitalization table
 - Legal structure and documentation
 - Strong credit scores (needed for debt financing)
 - Collateral (may be needed for debt financing)
 - Business valuation (needed for equity financing)
 - Terms of the equity being offered (needed for equity financing)
- **Types of Debt Options for Small Businesses**
 - Small Business Administration (SBA) Loan
 - Traditional Bank Loan
 - Line of credit
 - Microloans
 - Business Credit Card
 - Promissory note
 - Alternative sources/financing
- **Types of Equity Options for Small Businesses**
 - Angel investors
 - Venture capital
 - Crowdfunding
 - Family & friends

❖ **Debt Financing:**

- **Possible Documentation**
 - Commitment Letter
 - Loan Agreement
 - Promissory Note

- **Pros of Debt Financing:** 1) Retention of business ownership and decision making; 2) Fixed loan repayment schedule; 3) Relationship with lender ends once loan is repaid
- **Cons of Debt Financing:** 1) May be difficult to obtain 2) Repayment obligation; 3) Restrictive covenants; 4) Interest; 5) Consequences of failing to repay the loan; 6) Collateral/Guarantee requirements

❖ **Equity Financing**

➤ **Possible Documentation**

- Term Sheet
- Updates to corporate governance documents
- Shareholder/Investor Agreements
- Convertible Note Agreement
- Subscription Agreement/ Share Purchase Agreement
- Shareholders and Board of Directors Consent

- **Pros of Equity Financing:** 1) Typically no repayment requirement (dependent on structure); 2) Shared risk; 3) Access to investor expertise; 4) No collateral requirements

- **Cons of Equity Financing:** 1) Loss of control; 2) Profit sharing; 3) Time-consuming; 4) Ongoing relationship

❖ **Overview of Securities Law**

- **Securities include** notes (except most promissory notes and other instruments evidencing a loan), stocks, bonds, “investment contracts”
- **Applicable Securities laws:** Federal level: Securities Act of 1933; State Securities laws (“Blue Sky Laws”)
- **Key Considerations for Small Business Owners to Avoid Securities Law Issues**
 - **Exemptions from Registration:**
 - Private Offerings – Section 4(a)(2) under the Securities Act; Rules 504, 506(b) and 506(c) of Regulation D
 - Regulation Crowdfunding
 - Intrastate Offerings
 - Regulation A - “Mini-public Offerings”
 - **Accredited vs. Non-Accredited Investors**
 - **Anti-Fraud Liability**
 - **Filing Requirements**

❖ **Buying or Selling a Business with the Help of an Investor**

- This involves purchasing an established business, where an investor may be involved.
- **Considerations:** Due diligence; Business valuation; Structure of the deal (debt v. equity); Legal agreements and documentation; Securities law compliance