

Creative Debt and Equity Financing for Small and Medium Size Businesses

Jason Kuruso, MBA, CPA

With over ten years in assisting small and medium size business to obtain financing I've found that many business owners and their financial professionals have no idea that there are only two types of financing programs in the entire financing system. One is debt (loan or line of credit), the second is equity, that is when a company sells off a portion of its stock to raise capital. Hopefully the information in this article will be information to assist the small and medium size business owner to look "out-side the box" for financing alternatives. You will not find this type information in any of the books at a book stores or business schools.

A term related to the title of this article is creative financing, no!, it has nothing to do with anything illegal. We see financing in the small to medium size businesses as conventional or creative. Conventional means going to the get a SBA loan or borrow from family or friends to operate a business. Creative means using a variety of tools and techniques currently in use by the major corporations or investment banking companies. Some of these techniques are equity financing using the SBA regulation "D" 504 program to raise capital by selling off stock in your company. A second approach is for debt financing (Loan or Line of credit), that are a many ways, too many to list in this limited worded article. Just to name a few of my favorites are; asset financing , balance sheet enhancement, securitization financing, structured financing. Lets take a closer these and their requirements.

Raising Equity Capital (selling Stock) using regulation "D"

Regulation D -- Rules Governing the Limited Offer and Sale of Securities Without Registration Under the Securities Act of 1933

US Congress passed this bill for the sole purpose of small business to raise financing and if one were to take poll, they will find that nine of ten small business owner have no knowledge of this program. For some reason the government agency does not market this program, the only program that is marketed is the small business loan which is no bargain for the small business owner. The different levels for equity fund raising are as follows;

Rule 504 -- Exemption for Limited Offers and Sales of Securities Not Exceeding \$1,000,000 per one company
In one year.

Rule 505 -- Exemption for Limited Offers and Sales of Securities Not Exceeding \$5,000,000 per year

Rule 506 -- Exemption for Limited Offers and Sales Without Regard to Dollar Amount of Offering

Rule 507 -- Disqualifying Provision Relating to Exemptions Under Rule 504, Rule 505 and Rule 506

SBA Score—Small Corporate offering same requirements as the 504, but is restricted to any given state.

Keep in mine that any small or medium size business from start-up to existing operating companies qualify to use this program. However, it is a little more involved in terms of paperwork and regulations. To make an offering one need a Public Offering Memorandum better known as a "PPM" which is a more sophiscated business plan with all the disclosures and qualifying documentation as to the type and number of investors. But in the end it is well worth the extra effort and cost if you have a good product or services and is a new company having difficulty obtaining a loan or line of credit. More Detail Information; Reference Securities and Exchange web site.

Structure Financing Techniques

Structured financing is a creative and innovative program that takes the guess work out of raising operational and expansion capital. Structured finance transactions are of increasing importance because

many institutional and investors are precluded by regulation, applicable investment policy, or by their constitutional documents from investing in certain types of securities. This may be because such securities do not have a rating from a rating agency or may not be listed or simply may not be recognized under applicable law and regulation as equity rather than debt.

Structured financing consist of debt securities issued by a customized corporation in the structured finance transaction. The transaction is structured to meet the requirements and in addition by use of swap agreements, the principal and income stream payable to the investor on the debt security issued by the customized company, the transaction may be customized as to currency and fixed or floating rates of interest. Furthermore, whilst the typical capital markets or structured finance transaction will issue a security to investors which is characterized as debt, that debt may carry with it an equity kicker so that in addition and for the benefit of the investor, it strips out from the customized company the whole or part of any debt security remaining after redemption of the principal and interest payments on the debt element of the security.

Collateral and Balance Sheet Enhancement Program

The collateral enhancement program is one of the best tools available for the entrepreneur today. Although few people are aware of the program, it gives the applicant the latitude to obtain that extra required edge to get ahead of the financial game. To make the program work the “client company” enters into a agreement with a third party investors for additional assets (collateral) as equity investment into the customized company which is owned by the “client company”. Which enhances the balance sheet with equity and later converts to debt. The collateral enhancement are in the form of AAA rated securities and are placed in a escrow account under the name of the customized company for the purpose of obtaining a rating and later raising the needed capital. Once the collateral enhancement is secured it is designed for the investment portfolio so that a “sinking fund” consideration as part of the instrument. As an example, one way the transaction could work is the applicant submits an application for commitment in the amount of \$43 million (US), we would obtain a commitment for \$100 million US in order to establish a sinking fund of \$57 million (US). The face amount of the instrument would be \$100 million (US) maturity; therefore, the funds that are payments must be made directly to the lending institution.

Securitization Financing Technique

This is my favorite program. Having difficulty qualifying for a loan, low or no credit rating, start-up and no track record, not in business more than two years, weak on your tax returns, etc, etc. with this program none of the above matters. 1. Very low institutional-level interest rates often below prime (on account of our low cost of funds); 2. Borrowers can structure repayment to match cash flow, availability to make no repayment on debt of interest or principal for 4-7 years after receiving funding. 3. Borrower can structure repayment of funding over any time frame from 2 years to 25 years; 4. Very streamlined transactions can close in less than two weeks, no covenants; 5. The program financing sources are -pension funds and insurance company endowments- do not focus on underlying business, no review of business model of borrowing entity receiving funding; 6. All funding are private placements, and are off-balance sheet so corporate assets are NOT attached for debt transaction. 7. No upper limit on funding per transaction, many deals have ranged over \$100 million per transaction deals. This securitization financing has many advantages over other debt funding options, 1. IT is fast , two weeks to fund, 2.. Not a great deal of red tape or long applications, 3. Not dependent on any type of credit scoring, 4. Delayed payment schedules.

Owners Be Aware of the Professionals Advice on these type programs

Some of the above programs fall under the investment banking heading and have been down sized for the small and medium size businesses and no many financial professionals and Attorney’s have knowledge of these programs. Over the past ten years and through the introduction of the above programs we have found that Attorney’s, CPA’S, Accountant’s and financial Consultants have no knowledge of the above financial programs outside of the SBA programs and will render a negative decision back to

the owner, Especially Attorney's which denies the company the opportunity for any of the above funding programs. This is understandable no professional in the financial field want to admit they have no knowledge of such programs especially when they are being paid a consulting fee or salary but this is such a disservice to the company and the poor owner continues to struggle to keep his/her above water to survive. Owners you are just as smart , Make your own decisions and you will end up all the better for it.

Jason Kuruso.MBA,CPA

Fargotrust@earthlink.net

Web Site; www.fargofinancial.com