Small Businesses Look to Alternative Funding Sources

Traditional bank lending is still the primary source of financing for small businesses, but companies are showing more of a willingness to turn to other options.

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Tracey West, the owner of an Internet-based cake business in the Atlanta area, has a better idea how to pursue different sources of financing after receiving advice and information at a financial summit at the Federal Reserve Bank of Atlanta earlier this year. The event highlighted nontraditional resources small businesses can tap, such as crowdfunding, which allows collaborative fundraising typically through the Internet, and community development financial institutions (CDFI), which primarily make loans to underserved populations.

In the Federal Reserve's most recent Small Business Credit Survey, half of businesses polled said they were approved for less capital than they sought between the third quarters of 2014 and 2015, with microbusinesses and startups noting the greatest amount of financing shortfalls. Entrepreneurs put some of their own skin in the game, as 21 percent of respondents said they used personal funds to aid their business.

"I've been leveraging credit cards for funding," said Steven Thompson, chief executive and president of Score Recruiting Solutions in the Atlanta suburb of Peachtree Corners. On the strength of his individual credit standing, Thompson was able to obtain short-term pay arrangements with several card issuers that eventually helped him establish corporate credit. He said it took diligence to make sure his personal scores remained creditworthy while ensuring the business was bringing in enough sales to pay the bills.

"I needed to build my company credit to the point at which I could get corporate credit cards," Thompson said. He's raised $50,000 for his business with credit cards and has been able to hire some people.

Anthony Flack, a commercial loan officer with Access to Capital for Entrepreneurs Inc. (ACE), an Atlanta nonprofit that is certified by the U.S. Treasury Department as a CDFI, said his company is receiving more requests for aid as economic conditions improve and interest in entrepreneurship rises. ACE provides loans and business counseling and receives most of its funding from banks, foundations, and the U.S. government. "Based on the demand I'm seeing, the business climate has increased," Flack said.

Crowdfunding, which raises money by inviting a large number of people to make small investments, just got a major shot in the arm nationally. In May this year, new rules from the U.S. Securities and Exchange Commission (SEC) took effect that allow startup companies to offer and sell securities directly to ordinary individuals. The rules let companies raise up to $1 million a year from friends and investors and are part of the 2012 Jumpstart Our Business Startups (JOBS) Act designed to help early-stage firms get quicker access to capital.

The crowdfunding rules were a major change in how startups and other small companies could raise funds. Previously, they
could approach only so-called "accredited investors" with a net worth of at least $1 million. Now, investors with a yearly income or net worth of less than $100,000 can contribute up to $2,000 annually. Early-stage companies cannot approach investors directly, but must raise funds through approved online crowdfunding platforms and will have to file annual financial disclosures with the SEC.

"It's going to raise the entire profile of this capital-raising revolution," said Jeff Bekiares, chief operating officer with SparkMarket, an Atlanta-based technology provider that helps businesses set up crowdfunding campaigns. "When folks who are already recognized names in the crowdfunding industry set up their sites and start running projects, there's going to be a real boost to awareness."

In recent years, some states approved exemptions that allowed crowdfunded equity/debt investing. At least 27 states currently have such exemptions, according to the North American Securities Administrators Association. In Georgia, for example, companies initiating crowdfunding projects must be registered in the state and have a principal office there.

Critics of equity crowdfunding say the SEC disclosure requirements and other regulations will make it a costly avenue for startups to raise capital. Bekiares says smaller companies will likely find it more practical to engage in equity crowdfunding at the state level. The businesses that have sought his company's help with crowdfunding offers so far are typically small or medium-size and looking for financing of $20,000 to $50,000.

"If you've got a small microbrewery and all you need is $25,000 or $50,000 to do an equipment expansion, you're much better off using the state-based rules and asking folks in your own community to fund that project," he said. "Ultimately, I think a lot of folks are going to cycle around to these local rules because they are much cheaper and easier to use."

Businesses responding to the Fed's Small Business Credit Survey indicated that they primarily sought loans and lines of credit for financing. Other financial products such as credit cards, leasing, and trade credit were also more popular than equity investment, which only 4 percent of applicants pursued.

West, the online bakery entrepreneur who is looking to expand her business with new personnel this year, says crowdfunding could be one piece of her financing plan. "The big 'aha' for me was realizing I don't have to choose just one (financing method); I'm able to combine different funding sources," West said. Crowdfunding "is a good way to show that public buy-in."

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