

**Ohio | Inc.**

Enterprise Appalachia  
**Enterprise Benchmarks**

Paper 1

## Enterprise Benchmarks: Finding Funding

Welcome to the first in a series of four *Enterprise Benchmarks* white papers, brought to you by **Enterprise Appalachia** ([http://ohiomeansbusiness.com/enterprise\\_appalachia](http://ohiomeansbusiness.com/enterprise_appalachia)) and *Inc.* magazine. This series explores the ideal location selection model for entrepreneurial start-ups based on four key criteria: capital, knowledge and labor, supply chain and market growth resources. This first issue, "Finding Funding," focuses on the types of funding most commonly required by small businesses and where to find the financing you need. Future papers will explore other access criteria of interest to entrepreneurs.

## 1. Introduction

At some point in their existence, most small businesses must face the prospect of finding additional funding. Some need outside financial help just to get their ventures off the ground, while others are able to bootstrap their companies through the initial stages, but require additional funds to grow their market share or expand geographically. No matter what type of funding needs they face, entrepreneurs should expect to encounter challenges in meeting them. In some cases—especially those involving bank loans and some other traditional sources of capital and credit—the challenges have been exacerbated by the difficult climate characterizing the U.S. economy during the past couple of years. However, with the right preparation, commitment and hard work, it is possible to overcome those challenges and find the funding needed to carry a solid business concept through the stages of launch, growth and broader expansion.

This white paper covers the range of resources available to entrepreneurs at various stages of their development and what they need to do to gain access to them. It explores a wide variety of funding options, including self-financing, friends and family, angel investors, bank loans and lines of credit, venture capital and government sources. Each is best suited to meeting a specific type of need. “What is most important is aligning a business’s needs for capital with the right source of capital,” emphasizes Michael Camp, director of the Center for Entrepreneurship at Ohio State University’s Fisher College of Business.

### **Basics of business funding: Equity financing and debt financing**

Any business seeking funding needs to consider its debt-to-equity ratio, which is a representation of the amount of money the company has borrowed and the amount the owners have invested in it. No matter what type of funding you seek, your chances are better if you have a significant amount of your own money invested in the venture. Financiers refer to this as having “skin in the game,” and most consider it critically important. Venture capitalists, especially, view that kind of personal investment as a demonstration of commitment, passion and belief in the future prospects of the company on the part of the owners. In general, the more money owners have invested in their business, the less difficulty they face in attracting additional financing.

**Equity financing** involves giving up a share of ownership in the business in exchange for capital. That ownership portion usually takes the form of stock in the company or a financial instrument convertible to stock at a prearranged price at some point in the future. The advantages of equity financing include access to needed funds without incurring additional debt, a structured repayment schedule or financing costs, all of which can strap a young business's cash flow. The obvious downside is giving up a percentage of ownership—sometimes a significant percentage, depending on the funding source—to outside investors. Some investors may also demand a voice in the business's decision-making process, a condition that some entrepreneurs find difficult to accept.

**Debt financing** entails borrowing money that must be repaid according to a set schedule, usually with interest. The most important thing to keep in mind with debt financing is making sure you know the total cost of the funding, not just the interest rate, Camp advises. Debt financing may involve loan-initiation and/or other fees and is often secured by some or all of the company's assets as collateral. In the case of a small business, many lenders also require a personal guarantee on the part of the owner in case of default. This is the lender's version of the skin in the game that equity investors look for as a sign of commitment.

Camp sees limited access to credit (debt financing) as the number-one funding challenge facing small businesses these days, especially startups. "Given the poor economic climate, banks look at startup companies as representing more of a risk than they did before," he avers. "This means more need for security and tighter lending requirements." For entrepreneurs, it also means more creativity may be required to secure needed funding.

## 2. First Stop: The Bank of Family & Friends

Actually, that should be your second stop. As stated above, any lender or investor will want to see that you have your own resources invested in the business before they put up their money. However, many entrepreneurs still need additional funding in the startup phase, and friends and family are sometimes willing to provide that funding on favorable terms. “We did the whole nine yards in our financing search, starting with friends and local investors who knew us,” says Michael Mark, CEO of ED Map, a Nelsonville, Ohio-based company that provides software and support services for online learning, corporate training and multi-campus colleges.

Mark focused on telling ED Map’s story to people who were successful in the local community and seemed willing to take a chance on another local entrepreneur. Not only did that funding provide critically important financial support during the company’s early years, it helped Mark develop the skills he would need to obtain additional funding from other sources down the road. “In my case, the biggest challenge I faced at the outset was a lack of knowledge about how and where to get outside funding,” he explains. “Once you know the ropes, it gets a lot easier.” Eventually, ED Map also received funding from venture capital firms and from the state.

There are some issues to keep in mind when seeking financing from family and friends. For example, startup businesses are inherently risky ventures, and you need to make family and friends aware of those risks. Also, it’s generally best to follow professional standards when structuring and documenting loans from family and friends. Failure to do so could have negative tax implications for both parties down the road, and it could also hurt your chances of securing financing from more traditional sources in the future. Peer-lending sites, such as **Prosper** ([www.prosper.com](http://www.prosper.com)) and **Virgin Money** ([www.virginmoneyus.com](http://www.virginmoneyus.com)), provide an easy way to structure these loans.

## 3. Angel Investors: Pennies from Heaven?

Angels are generally the next step in the small business investment continuum. Like friends and family, angels are often willing to invest in promising concepts in the earliest stages. However, they are likely to be more demanding in their expectations. They will want to see a solid business plan—which every business should have regardless—and receive regular progress reports. Angels typically enter into a deal only if it includes a viable exit strategy with the possibility of strong future profits.

There are two types of angel firms, says Karl Elderkin, founder and managing partner of Athenian Venture Partners, which has offices in Athens, Ohio, and Ft. Lauderdale, Florida. The first is the individual angel investor, who usually does a limited number of deals, sits on the boards of the companies he or she finances and often provides additional assistance or guidance related to operational or strategic matters. The second type is a group of angels working together and sharing deals with each other. Both types of angels tend to specialize in particular industries or businesses, so it's important to target your fundraising efforts appropriately.

For example, **Ohio TechAngels** ([www.ohiotechangels.com](http://www.ohiotechangels.com)) provides investment capital for the commercialization of innovations in information technology, advanced materials and medical technology. It is part of the **Ohio Third Frontier** ([www.OhioThirdFrontier.com](http://www.OhioThirdFrontier.com)) program, which is dedicated to accelerating the commercialization of high-tech research capabilities in the state. A listing of angel investment sources can be found at [www.angel-investor-network.com](http://www.angel-investor-network.com). Angel investors tend to conduct a thorough investigation (“due diligence”) of the companies that approach them for funding, a process that can take several months.

## 4. Bank Loans and Lines of Credit: Harder to Come By, But Not Out of Reach

Bank loans and lines of credit have always been one of the more difficult sources of funding for small businesses to obtain, and that's especially true for early-stage businesses. Things have been even worse than usual in recent years. The 22 biggest banks receiving Troubled Asset Relief Program (TARP) funds collectively reported a decline in their small business loan balance last year. The Ohio district office of the U.S. Small Business Administration (SBA) guaranteed just 1,250 loans in 2009, down from 2,300 in 2007, reports Thomas Mueller, the Ohio district director. However, the federal government has been taking steps to loosen up bank lending to small businesses recently.

"Banks are more interested in the past, how your company has performed historically," notes Lynn Gellermann, founding partner and president of **Adena Ventures** ([www.AdenaVentures.com](http://www.AdenaVentures.com)), which invests in early and growth-stage companies in Appalachia, and executive director of **TechGROWTH Ohio** ([www.techgrowthohio.com](http://www.techgrowthohio.com)), which connects early-stage, technologically innovative companies with valuable tools for growth and sources of capital. "Venture capital and angel firms are more interested in the future, your company's prospects for growth." Nonetheless, Gellermann adds, small businesses should not discount banks as a source of funding, even in the early stages. "They need to explore all their options. Bank financing can go hand-in-hand with bootstrapping, angel investments, credit cards, home equity, venture capital and government grants and loans," he advises. "Making use of all resources available is the sign of a true entrepreneur."

One of the best options for bank financing available to small businesses is the SBA's 7(A) Loan Program, which the government has been taking steps to revitalize. During a period of 2009 when the federal government increased the percentage of 7(A) loans it would guarantee and eliminated application fees, the Ohio district saw an increase in the number of loans it processed from 70 in March to 170 in September. "With and without the higher guarantees in place, we are averaging about 135 loans a month in 2010," Mueller says. "Continued higher guarantees and the suspension of fees through the end of the year would be a big help, and we strongly support that."

The SBA offers several other loan programs, including micro-loans, export assistance trade financing and international trade loans. More information on those programs and other assistance available from the Ohio SBA office can be found at [www.sba.gov/oh](http://www.sba.gov/oh). The agency's *Central & Southern Ohio Small Business Resource* publication contains much valuable information on those programs and can be downloaded as a PDF file at the site.

## 5. Venture Capital: Next-Stage Financing

Any small business that has ambitions to expand beyond being a mom-and-pop operation is likely to approach a venture capital firm for additional funding at some point in its development. As is the case with angel investors, venture capital (VC) firms come in all shapes and sizes, often specializing in specific types of industries or businesses and/or stages of development. Information about and links to numerous VC firms and other resources, both financial and operational, are available on the Access Capital page of the **Enterprise Appalachia website** ([www.ohiomeansbusiness.com/enterprise\\_applachia/capital\\_access/](http://www.ohiomeansbusiness.com/enterprise_applachia/capital_access/)).

While each firm will have its own process for applying for funds and its own approach to conducting due diligence, there are steps businesses can take that will improve their chances in almost all cases. For starters, a solid business plan is important. Help preparing one is available from business incubators and other sources, many of which are listed at [www.ohiomeansbusiness.com/enterprise\\_applachia/knowledge\\_labor\\_access/](http://www.ohiomeansbusiness.com/enterprise_applachia/knowledge_labor_access/). Adena Ventures and some other VC firms also offer help in this area. Business owners who are new to this aspect of fundraising might benefit from a coaching session or two, seasoned entrepreneurs advise. It also pays to know somebody. “The best way to successfully approach a VC is through a referral,” suggests Athenian’s Elderkin. “If you don’t have a referral source, you need to find one.”

Dan Meyer, president of Comet Solutions, a Cincinnati-based company that develops and markets product development simulation technology, has played a leadership role in several early-stage companies and advised others. He believes the most important thing business owners need to keep in mind when approaching a VC firm is that they are “selling” their company to a prospective investor and need to make it as attractive as possible. “There is a widespread misconception that VCs are great risk-takers, but nothing could be further from the truth,” he says. “Their primary objective is to earn a return on their investment, and the entrepreneur’s biggest challenge usually is convincing the VC that their business is *not* too risky.”

The best way to do that is by being prepared to show the VC as many validation and proof points as you can assemble, Meyer advises. Document your existing customers and prospects. Provide a clear explanation of the problem your product will solve or the market void it will fill. Enlist industry experts and business partners to validate your propositions. Proactively acknowledge any deficiencies you currently face, such as lack of a sales force or an experienced management team, and demonstrate that you have a plan in place to address them. It can be helpful to show how the funding you seek will be used to execute that plan. “Your job is to convince the investor that, yes, there is risk involved, but you understand the risks, they are manageable, and you are doing everything possible to reduce them,” Meyer says.

## 6. Government Funding: Help from Uncle Sam

Funding in the form of loans and outright grants is available to small businesses from a wide array of federal, regional, state and local government sources. Much of the funding available is earmarked in some way (i.e., targeted to a specific industry or geographic location or to the solving of a specific scientific or technological challenge), but there is plenty of money available for more broad-based business purposes as well. “Always look for community or government grant money if it is accessible,” says Elderkin. He advises companies in the biotech field to approach organizations such as the National Cancer Institute and the National Institutes of Health for research grants. Cooperative Research and Development Agreements, which combine government and private-sector assistance have become common in many industries, especially technology and life sciences. Some programs target minorities, women or those located in economically disadvantaged areas. The Access Capital page of the Enterprise Appalachia website provides links to a variety of resources in this area.

## 7. Conclusion

Finding funding is among the biggest challenges entrepreneurs face even in the best of times, and there is no question that the task becomes more difficult in a strained economy. Still, there's funding to be had out there for those business owners willing to devote the time, energy and commitment needed to secure it. Most of the experts interviewed for this white paper suggest that the best prospects are those closest to home, although in some cases it may make sense to cast a wider net. "Relationships are a big part of this, and they usually work best when both parties are local or at least in the same region," notes Gellermann. "There is a shared sense of place and a better understanding of what each is trying to accomplish. But expanded networks make sense when you reach a certain level of growth. Broader geographic reach also makes it easier to syndicate and bring in other capital."

Veteran business owners warn that timing is also a critical component of fundraising. "It's best to bootstrap the early stages, because your first customers usually don't turn out to be your best customers," says Pamela Springer, CEO of Manta Media, a provider of small-business information based in Westerville, Ohio. Most companies devote significant time and resources to fine-tuning their products or services during their first few years in business, and burning through their funding in that stage can be a mistake. "It's more important to have it available when you're done with that stage. You won't have the money you need to scale up if you used it all for R&D," she says.

### **Coming in the Next Issue of *Enterprise Benchmarks*: The Educated Entrepreneur—Building Your Knowledge Base**

Staying ahead of the competition and knowing your market means educating yourself. This paper will outline a wide range of resources, including online databases for competitive research; CEO peer organizations; executive MBA programs; executive coaching; Small Business Development Center programs; and more.

### **Enterprise Appalachia Resources: Access to the Capital You Need**

Without capital, great ideas die inglorious deaths. Fortunately, Ohio's Enterprise Region makes it easy for you to access capital to efficiently and successfully transition your product or service from R&D to commercialization, with resources all within your

geographic reach. Entrepreneurs locating in Ohio Appalachia benefit from regional venture capital and financial support that meets the needs of all businesses, from startups to fast-growth companies. The following links can help you learn more about Appalachia Ohio's capital opportunities.

- **Adena Ventures** ([www.adenaventures.com/default.aspx](http://www.adenaventures.com/default.aspx))—The Adena Venture Fund, a \$34 million venture capital enterprise, provides equity capital and operational assistance to high-growth businesses at various stages of development across a broad range of industries from cutting-edge technology to more traditional opportunities, operating in central Appalachia.
- **Athenian Venture Partners** ([www.athenianvp.com](http://www.athenianvp.com))—Athenian Venture Partners is an Ohio-based venture capital firm with principals located in Boston, San Diego and London, focusing on early-stage investment opportunities in the Information Technology and Life Science Industries.
- **Ohio Tech Angels** ([www.ohiotechangels.com/about\\_us.htm](http://www.ohiotechangels.com/about_us.htm))—The Ohio TechAngels (OTA) provide investment capital for commercialization of innovations in life sciences, information technology and physical sciences. The goal of all OTA funds is to support Ohio-based technology investment opportunities by facilitating risk sharing on early opportunities with high upside potential.
- **The Progress Fund** ([www.progressfund.org/main.htm](http://www.progressfund.org/main.htm))—A community development financial institution, the Progress Fund provides capital and coaching to new or expanding businesses that will build the local economy. Since its inception in 1997, The Progress Fund has made 149 loans totaling more than \$11 million, created or retained more than 855 jobs, provided at least 5,000 hours of business counseling and helped reuse 60 historically-significant buildings.
- **Appalachian Regional Commission (ARC)** ([www.arc.gov](http://www.arc.gov))—In administering the ARC funding programs, The Governor's Office of Appalachia has established a series of linkages with a wide assortment of local, state and federal initiatives to help entrepreneurs and grow business.

- **Ohio and Huntington Job Growth Partnership** (<https://www.huntington.com/growohiobusiness>)—Initiated May 2009, The Ohio Huntington Job Growth Partnership is a groundbreaking three-year, \$1 billion public-private lending partnership to attract, retain and grow businesses and jobs. The statewide program offers a \$1 billion lifeline in new credit to small to medium-sized businesses to help retain employees or hire new ones. The partnership leverages existing State of Ohio and U.S. Small Business Administration loan programs to maximize availability of funds for companies located in or moving to Ohio.
- **Ohio Third Frontier** ([www.thirdfrontier.com](http://www.thirdfrontier.com))—Initiated in February 2002, this project is the state’s largest-ever commitment to expanding Ohio’s high-tech research capabilities and promoting innovation and company formation. The 10-year, \$1.6 billion initiative is designed to:
  - build world-class research capacity;
  - support early stage capital formation and the development of new products;
  - finance advanced manufacturing technologies to help existing industries become more productive; and
  - through the Ohio Third Frontier, boost additional federal and private sector support to more than \$6 billion.

Learn more about the Third Frontier Programs at [http://thirdfrontier.com/FiscalYear2010\\_ProgramOpportunities.htm](http://thirdfrontier.com/FiscalYear2010_ProgramOpportunities.htm).

- **Appalachian Center for Economic Networks (ACENet)** ([www.acenetworks.org](http://www.acenetworks.org))—ACENet focuses on small businesses, including startups, primarily in the food, agriculture, artisan and wood sectors, giving priority to those who are lower income and reside in Appalachian Ohio. The areas of support provided by ACENet include:
  - **ACENet Business Innovation**—Adult and youth entrepreneurship training.
  - **ACENet Food Ventures**—Assistance to startup or existing small food businesses.
  - **Business Facilities and Networking**—Office, light manufacturing and warehouse space
  - **ACENet Ventures**—Business loan opportunities.
  - **ACENet Institute**—Research and policy development

- **Revolving Loan Funds**

- **Ohio Mid-Eastern Governments Association (OMEGA)**  
([www.omegadistrict.org](http://www.omegadistrict.org))
- **Buckeye Hills-Hocking Valley Regional Development District (BH-HVRDD)** ([www.buckeyehills.org](http://www.buckeyehills.org))
- **Ohio Valley Regional Development Commission (OVRDC)**  
([www.ovrdc.org/index.html](http://www.ovrdc.org/index.html))

- **Entrepreneurial Signature Program (ESP)**—The purpose of the ESP is to significantly increase technology-based entrepreneurial commercialization success by accelerating growth in strategic technology-based sectors that offer exceptional economic development prospects. Each ESP represents a comprehensive, coordinated network of high value services and assistance providers that is visible and easily accessible to technology-based entrepreneurs and small tech-based companies.

- **CincyTech** ([www.cincytechusa.com](http://www.cincytechusa.com))
- **JumpStart** ([www.jumpstartinc.org](http://www.jumpstartinc.org))
- **TechColumbus** ([www.techcolumbus.org](http://www.techcolumbus.org))
- **TechGrowth** ([www.techgrowthohio.com](http://www.techgrowthohio.com))

- **Preferred Treatment**—Additional State of Ohio incentives are available in Priority Investment Areas, which include most Appalachian counties. Qualifying companies can benefit from:

- **The Manufacturing Machinery & Equipment Tax Credit**  
([www.odod.state.oh.us/edd/itc](http://www.odod.state.oh.us/edd/itc))
- **Rural Industrial Park Loan Program**  
([www.development.ohio.gov/EDD/loans\\_grants.htm#RIPL](http://www.development.ohio.gov/EDD/loans_grants.htm#RIPL))
- **Job Creation Tax Credit** ([www.development.ohio.gov/edd/jctc](http://www.development.ohio.gov/edd/jctc))
- **Technology Investment Tax Credit Program**  
([www.development.ohio.gov/tech/titc](http://www.development.ohio.gov/tech/titc))

## **Enterprise Appalachia: The *Right* Resources in the *Right* Location**

Ohio's 32 Appalachian counties are well-known for their beautiful scenery, rich culture and timeless traditions; they also boast a welcoming business climate, skilled workers with a strong work ethic, and an affordable cost of living. The traditional assets that have been the foundation of the Appalachian region's economy for centuries are supporting new and emerging opportunities for the region today.

**Enterprise Appalachia** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/](http://ohiomeansbusiness.com/enterprise_appalachia/)), an initiative developed by the Governor's Office of Appalachia, was created specifically to help make entrepreneurs aware of all the benefits and resources the region provides.

Choosing a location is an important strategic choice, one that should be based upon a thorough consideration of established criteria and relevant data. Entrepreneurs must set aside stereotypes, prejudices and preconceived notions and make the choice accordingly based on solid, accurate information. Enterprise Appalachia is all about offering the useful insights and resources that can help you make the choice.

The website offers access to a wide range of resources offered by the region, including **Capital** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/capital\\_access/](http://ohiomeansbusiness.com/enterprise_appalachia/capital_access/)); **Knowledge & Labor** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/knowledge\\_labor\\_access/](http://ohiomeansbusiness.com/enterprise_appalachia/knowledge_labor_access/)) ; **Supply Chain** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/supply\\_chain\\_access/](http://ohiomeansbusiness.com/enterprise_appalachia/supply_chain_access/)); **Markets** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/market\\_access/](http://ohiomeansbusiness.com/enterprise_appalachia/market_access/)); **Life Balance** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/access\\_your\\_life/](http://ohiomeansbusiness.com/enterprise_appalachia/access_your_life/)); and much more.

For today's capital investor, every dollar is a precious commodity. The more investment capital that actually makes it to product development and commercialization, the greater the probability of success, and the faster the return on investment. That's why site selection is so critically important. The ideal location maximizes the value of the investment by delivering a perfect balance between access to mission critical resources and low overhead costs; a balance that can be found in Appalachia.

## **Successful Site Selection, Successful Business**

The location needs of entrepreneurs are different from those of established businesses. Most startups and early-stage businesses don't have the same level of available financing. They don't have internal laboratories and R&D departments or supply chains. While an established business has the ability to draw from its existing networks to find what it needs, an entrepreneur must find the perfect balance of resources and low

costs. All of those needs make selecting the right site—one offering the resources to answer a wide array of entrepreneurs' challenges—critical. For the entrepreneur, getting it right the first time is imperative.

Appalachia Ohio's Counties offer access to these resources and much more. Go to **Enterprise Ohio's "Ideal Site Selection Criteria" page** ([http://ohiomeansbusiness.com/enterprise\\_appalachia/ideal\\_selection\\_criteria/index.php](http://ohiomeansbusiness.com/enterprise_appalachia/ideal_selection_criteria/index.php)) to learn more about all the tools the region features; not just to get you off to the right start, but to *keep* you on the path to success.