



Funding a Business with Equity – Not Debt!

The Global Entrepreneurship Monitor suggests that 20% of new businesses in the United States fail in the first year (Barringer and Ireland, 2006). The most common reason for business failure is insufficient operating cash. New businesses are often more expensive than anticipated. The initial cash flow sometimes cannot support the business overhead, draining cash reserves over a period of time until an owner is forced to close it down. SBA loans and Home Equity Lines of Credit (HELOC) are the most common forms of business financing. Both of these types of loans are tremendous solutions in rate-driven markets. However, when interest rates are on the rise, as in recent years, business owners find their variable SBA loan and HELOC payments (company overhead) rising as well. Since July 2003, the Federal Reserve has raised the Prime Rate nine times to the latest rate of 8.25 – the same place we found it in 1996. Because of this, HELOC and SBA loans are commonly being offered at between 10 and 13 percent.

Rising interest rates are a significant reason why companies like Guidant Financial Group are experiencing such tremendous growth. Guidant helps individuals buy a business or franchise using their retirement funds without taking a taxable distribution. Since 2004, Guidant has experienced an increase of more than 400% in their business funding services. David Nilssen, CEO and co-founder of Guidant, attributed the company's significant growth to "greater awareness of this strategy in the general business community. CPAs and attorneys are beginning to embrace and understand the benefits their clients can receive by utilizing this form of financing." Guidant can help individuals establish plans that allow their retirement funds to invest in their new business. "It is very similar to buying stock in Microsoft inside a 401(k)," Nilssen said. "In this case, we're talking about a privately held company as opposed to a publicly traded entity."

Entrepreneurs who feel their new business opportunity would be a worthwhile investment for their retirement plan may have a great chance of business success. It is possible to use a HELOC or SBA loan in addition to retirement financing. Nilssen suggested that it is preferable to buy the business entirely with retirement cash. "A tremendous benefit is that our clients are buying a business with equity, not debt. They're not obtaining a loan. They are using cash from their retirement plan. This means the initial revenue the business generates can be reinvested in the business rather than sent to a bank in the form of interest payments."

For a small business or franchise owner, using retirement money could significantly improve the longevity and ultimate success of that business. For instance, a \$150,000 SBA loan obtained today at an 11% interest rate for 10 years would require almost \$100,000 in interest payments. Using equity rather than debt to buy the business would not only save nearly \$100,000 in interest, it would free up more than \$2000 each month for reinvestment back into the growth of the business. Nilssen explained that using retirement funds to purchase a business offers additional benefits, such as allowing the owner to contribute more money into their retirement plan and if the business is successful the profits generated will increase the value of the plan.

Chicagoland Sunbelt is a Business Brokerage firm that focuses solely on helping people buy and sell businesses. We are also a proud member partner of Sunbelt Midwest, which has offices in Minnesota, Wisconsin and Illinois.

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