The Right Financing

How to Choose Between Investor Capital and a Business Loan

Brock Blake is the co-founder and CEO of Lendio.com.

Six years ago I started FundingUniverse to help business owners connect with investors. Soon we learned we were turning away about 90 percent of our business. The challenge we found over and over and over again was that most angels are looking for a very specific type of company to invest in.

We had restaurant owners, land owners, landscapers, consultants and dry cleaning shops that we were trying to fit into this little box. One hundred entrepreneurs were coming into the door, and maybe five of them would fit into that box. For everyone else, We were basically saying, "Hey, you're not going to be able to get angel or venture capitalists."

These were great people with great business ideas and opportunities to make a great living. Regardless, they weren't a good fit and would not get investors to take a second look.

I think the same thing happens to many businesses in the state of Utah and around the country that are looking for funding—they're trying to get financing from the wrong places.

The right financing will determine how quickly a business will grow, and sometimes whether or not the doors will open another day. But many business owners don't understand the types of capital that best fit their business, or how to pursue it.

For instance, Barbara Corcoran, an angel investor and host of the ABC TV show "Shark Tank," told us on the Lendio.com blog that she tires of hearing the same restaurant pitch from every cabbie in New York City.

"The last thing I want to hear is, 'My brother and I want to open up a restaurant,'" she said.

Angel investors and venture capitalists are rarely ever going to fund most Main Street America businesses. Those investors are looking for the next Facebook, Amazon and Google. For most small businesses, it's a better fit to pursue a business loan or even a line of credit.

The numbers tell the same story. We did a recent study comparing equity investment and business loans across the country. Combined, angels and venture capitalists invested a little more than $40 billion in 2010. In comparison, the total number of small business loans of $1 million or less was $653 billion in the same year. In 2011, loans guaranteed by the Small Business Administration hit record highs of more than $18 billion.

With business loans averaging about $600 billion more than investment capital, choosing to secure a loan dramatically increases your chances for financing.

A couple years ago, when we realized we were turning away most of our customers, we tried to figure out a different way to help those businesses get the capital they need.

We asked ourselves things like, "Can we help them get a business credit card? Can we help them get an SBA loan?" As we started to explore those questions, we started to get capital for business owners at rate that was much faster than helping them get angel or VC financing.

Instead of trying to push this big, resistant ball up the hill, we started to get over that hump and the ball started rolling on its own. Business owners started getting financing because we were fitting them into a much bigger, comfortable box that included various types of business loans instead of just investment capital.

However, if you are one of those companies that is a good fit for an investor, make sure you know what you're getting into. For many, a business loan is a smarter option for the future of your business anyway. A bank will charge you interest, but they're not going to take a bite of equity or demand control over your company.

At the same time, if you need that extra boost to go national, equity financing can be a good idea. When choosing between debt or equity, consider:

Cost of borrowing: Share of ownership in the business compared vs. having to repay money over a period of time, usually with interest.

Benefit to company: No repayment, can obtain funds without incurring debt, and the potential advisory/leadership role for investor vs. not being required to relinquish ownership or control.

Risk to company: Potential for conflict with new stakeholder vs. being personally responsible in case of default.

Primary source: Venture capital and angel investors vs. Banks, credit unions and other lenders. UB

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