How Does a New Business Pay for Start Up Expenses?

With an estimated 495,000 new businesses starting up each month, new entrepreneurs are searching for financing answers.

The key to financing a start-up business is to first understand your business start-up expenses and cash flow cycle. Start-up costs include capital expenditures (hard costs) and working capital (soft costs). Determining exactly how much start-up capital you need means preparing realistic projections of the cash flow cycle starting with the ramp-up period when the business may not be generating any outside sales through the stabilization period when you start generating enough income to pay for most of your ongoing expenses. Some other tips include:

Be realistic in your estimates.
"Most start-ups underestimate their ramp-up timeframe and consequently under estimate the amount of working capital needed during the ramp-up period." says Deanne Geile, Business Baker at Huntington Bank in Michigan. Deanne suggests that instead of planning for the best case scenario, business owners should plan for the "what" scenario:

- What if we don't generate $X of sales as anticipated?
- What will we need to keep operations going until sales increase?
- What is our contingency plan?

In addition to creating a solid business model, business owners also need to think about the "how" scenario:

- How can I generate income from my business?
- How can I create leveraged income?
- How can I create passive income?

These questions help you to identify start-up costs and should also be included in your business plan.

Consider the type of financing you will be using.
Once you determine those start-up costs, you need to consider the types of financing you will be using. Two types of financing are debt and equity financing.

•Debt financing, means a loan from and outside source that will need to be repaid at some point in the future.

•Equity financing is an investment of dollars by an owner or other interested partner in exchange for a portion of ownership.

Many small business start-ups use a combination of using their existing savings, debt or equity financing.

New business owners need to be careful about the expectations regarding the debt to equity ratio of financing, meaning the percent of debt versus the percent of equity financing. "Any financing entity will want to see a similar or proportional level of equity financing by the owner. Lenders want to see that the owner has "skin" in the game." says Geile.

Remember, if you want someone to invest in you, you must first invest in yourself.

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