Isaacs Advisory

Financing Advisory Services

Starting or running an early stage business? There are more financing options than you may think!

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People are often surprised to learn that there are many more financing options available for start-ups and early stage businesses than they realized. Typically, both traditional banks and several non-traditional lenders operating in the Canadian financing marketplace provide these debt financing (as opposed to equity financing) solutions.

It is also useful to clarify what we actually mean by “start-ups” and “early stage businesses”. I have heard people say Tesla and Uber are “start-ups”, but they have clearly been operating for several years. For the purposes of this article, I will refer to business ideas or plans at their infancy stages as “start-ups” and organizations that are already operating and developing products or services as “early stage businesses”. The latter group is likely generating revenues, but may not be profitable yet.

Below is a summary of the various financing solutions available for both start-ups and early stage businesses, and some that are available for either one or the other.

Traditional Bank Solutions

As banks typically require a track record of profitability, they tend not to finance early stage businesses unless they have hard collateral, such as a mortgage on real estate. However, some will finance a start-up based on an acceptable business plan and the financial position of the business owner.

Term loans – Some banks will approve term loans for start-ups, primarily based on the business owner’s personal credit score and overall personal financial position. The better your score and financial shape you are in, the higher chance of being approved. Banks will normally require the personal guarantee of the owner. However, it is important to apply for the loan at the very beginning of your venture; otherwise, lenders will want to see a history of profitability. These loans are generally only available to start-ups and not early stage businesses (unless hard collateral is provided).

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Government-backed term loans – The Canadian government has a loan program in place called the Canadian Small Business Financing Loan (CSBFL), previously called the Small Business Loan (SBL). Although traditional banks provide them, the government backstops them. You can only use these loans to finance fixed assets (such as machinery, equipment, computers and real estate) and leasehold improvements to any rented or owned real estate. In most cases, they are capped at $350,000, but you may get approved for up to $1,000,000 if using to purchase real estate. They also normally require a personal guarantee on all or part of the loan.

Revolving lines of credit – Some banks will also approve a small revolving line of credit to support start-ups, primarily based on the strength of the owner's personal credit score and financial position.

Personal loans backed by real estate – Many people starting businesses take a loan from their bank, secured by either a first or second mortgage on their home (or other types of real estate to which they may have access). There are many smaller niche residential lenders that have less onerous application and approval criteria than traditional banks and only marginally higher costs. As they will provide second and sometimes third mortgages, these lenders can also be a good source of financing for start-ups or early stage businesses.

Non-Traditional Solutions

There are several Canadian non-traditional lenders that can provide financing to start-ups and early stage businesses. While more expensive than traditional bank financing (rates can range from 12% to over 25%), most of these options are short-term and more appropriately viewed as cheap equity alternatives.

Some lenders provide financing to start-ups or early stage businesses with hard collateral, such as machinery and equipment, inventory or real estate.

Factoring or invoice discounting – Several lenders offer these loans, which let you receive money right away when generating an invoice. While most customers take 30 to 90 days or more to pay, this method enables you to convert the invoice into immediate cash. There are numerous aspects to understand when considering this solution, however, such as whether it is provided on a notification or non-notification basis (i.e. whether your customer is aware of the factoring arrangement), as well as the recourse periods, advance rates, and if you need personal guarantees. Interest rates can also vary widely among lenders.

Asset based loans (ABL) loans – Some lenders provide financing to start-ups or early stage businesses with hard collateral, such as machinery and equipment, inventory or real estate. They typically require an appraisal and will lend against either their orderly or forced liquidation values of the assets. In addition, lenders look at the strength of the business plan, and the owner's personal financial position, experience and track record. These loans are generally one-year in duration and could include renewal options. Leasing may also be available for machinery and equipment, vehicles, etc. which has the benefit that it may not reduce the amount of financing available through other means.

Scientific Research and Experimental Development (SR&ED) – For businesses that spend resources on scientific research and development, these costs can often qualify for SR&ED refunds from the federal government. There are also lenders that provide financing to both start-up and early stage businesses secured by these pending SR&ED refunds.

Venture loans – These types of loans are well suited to early stage businesses (not start-ups) with a product or service that is, or just starting, commercialization. The organization could still be operating at a loss, but breaking even should be attainable within the next six months. While these loans may require a limited personal guarantee and have 15%-18% interest rates, their repayments can be tied to business revenue, so they are aligned with performance.

Other options – There are additional niche financing products that have come to market over the years, such as royalty financing and digital marketing financing. Further, some lenders lend based on Intellectual Property, or offer Software as a Service (SaaS) financing solutions. The availability of these loans is mainly driven by the facts at hand.

It is useful to be aware that, among all lenders, there are different loan minimums and some preference for certain asset types over others. Given the start-up or early stage nature of your business, many lenders may also require either your full or limited personal guarantee. This does not mean you need to provide a charge on your home, but you may be liable to repay the loan in the event your business fails.

Whether dealing with a traditional or non-traditional lender, one of the key aspects they will want to know is your capacity to either inject capital or raise additional debt or equity to put in the business if needed.

At Isaacs Advisory, we have extensive experience in advising on, structuring and sourcing a wide range of traditional and non-traditional financing solutions for small and medium sized businesses.

For more information on financing solutions for a start-up, early stage, growth, in-transition or businesses in distress, please contact Adrian Isaacs at (416) 835-4511 or aisaacs@isaacsadvisory.ca.