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Creative Financing for Buyers with Limited Capital

Some buying and selling of businesses' transactions may need creative financing. There are a number of creative financing options to consider.

1. **Seller Financing** - In such a scenario, the seller will hold a note at an agreed upon interest rate for a specific term or amortization – generally ranging from five to 10 years. The terms of the sale may include a balloon payment three to five years after the purchase date. It's a way of giving the buyer time to get up and running and to establish a successful track record with the business. Seller financing makes the bank more comfortable with the transaction. Lenders know they have a seller who has a vested interest in the success of the business rather than one who will take their money and run.

2. **SBA Loans -** In sales of a business, conventional loans usually aren't available, so a buyer may want to consider going to a Small Business Administration (SBA) lender, which has a number of loan options. The SBA guarantees a portion of the loan. The buyer pays an SBA loan fee that allows them to get funding for a loan the bank couldn't do conventionally. If an SBA guaranteed loan goes into default, the SBA will pay the lending institution up to 75 percent of any deficit left after liquidating the collateral.

3. **Earnouts** - Earnout financing involves a certain dollar amount agreed on by the buyer and seller to be paid to the seller based on the performance of the company after the transaction is completed. Earnouts can be structured in a variety of ways and can be based on different financial benchmarks such as a company's revenues, gross profits or net income. Earnout financing is often used for companies that are in a turn around situation or when buyers are purchasing on potential, rather than on historical cash flow.

4. **Mezzanine Financing** -In mergers and acquisitions, mezzanine financing is another alternative for a buyer looking for capital where the financing package may include interest rates of 20 to 30 percent. The lenders in this situation are typically high net worth individuals who are expecting a larger return on their investment. They are lending in a junior lien or a position behind the bank and seller financing. The loans are typically made with limited sources of collateral, thus the request for higher interest rates. Again, this financing is often used in funding goodwill or reputation in an acquisition.

5. - **Funding Scenario** -In a million dollar transaction, the buyer would be expected to have a 20 percent down payment. The seller may hold an additional 10 to 20 percent in seller financing, and the lending institution would offer a combination of conventional or SBA financing to cover the difference, depending on collateral available. A buyer and the lending institution must evaluate a company's cash flow and determine if it is adequate to cover their debt service and provide a reasonable return on their investment. Lending institutions will also be examining whether a buyer's coverage ratio, or excess cash
flow after all debt is paid, is adequate to cover their needs.

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