Step 3: Find Out Where to Get the Money You Need

Determine your available sources of funding. Not all of the following sources are available to you, but you can certainly position yourself, given enough time, to potentially benefit from one or all of these resources in the future if you know where to look and how to prepare and if you plan ahead.

Available sources of funding can include liquid assets, fixed-asset equity, banks and credit unions, borrowing from your 401(k), Small Business Administration grants, investors or partners, and credit cards.

Liquid Assets

Liquid assets are the easiest form of financing a start-up company. It involves cash or any possessions that can easily be converted to cash. Start accumulating assets (items you can acquire that appreciate in value with time or with a bit of sweat equity), create a side business to generate cash (e.g., tutoring service, lawn care, or a side job), or invest cash earned and saved (business or property) as early as possible to use for your eventual start-up capital. Remember, your goal is to be an entrepreneur, and that is much harder to accomplish if you spend all the cash you have or earn and if you buy into liabilities instead of assets.

I had managed to save up enough cash through the other investing options listed, mostly by buying and selling real estate, usually my principal residences. I would buy fixer-uppers in nice neighborhoods for significantly below market value, fix them up gradually while I lived there for a few years, and then sell them at a profit. The rest of the cash was what I could accumulate from saving throughout the years. This method afforded me enough cash to launch my company.

Fixed-Asset Equity

The biggest fixed asset one could use to help with the company start-up expenses is one's home or condo. You can do this either by continually (every few years) buying low and selling high or by taking out an equity line of credit. I am not a fan of renting, because I feel that you are providing the financial benefit of increased home equity to someone else instead of yourself. I would much rather live with my parents and wait until I could afford to buy a modest place of my own than rent. I was never a fan of paying someone else's mortgage, taxes, and insurance so that they could gain equity in their property, at my expense, while the hard money I earned was put to no investment use. If you could plan far enough ahead and purchase your first home with the intention to use its future equity, it would be a good source of start-up financing. Of course, it is very important that you have and maintain great credit.

There is an art to buying a house with the intent to use potential equity in the future. Whereas in the typical purchase of a house you would look for a very nice house, buying a house for investment purposes has totally different research parameters. You want to buy the ugliest house *in the nicest neighborhood* with potential for appreciation. As long as the required repairs are cosmetic in nature and not structural, buying an ugly house allows you to buy at below-market value; by doing so, you lower the monthly mortgage payments. You can then defer the required costs to upgrade the house and perform the repairs at your own pace. By doing this, you increase the value of the house and the equity.

Every property that I have ever bought has been a property that most people would have walked away from because of its current condition. But I learned to look at the potential of a property and focused on the neighborhood instead of the shape and condition of the house. I made sure that the neighborhood was nice and that the houses around the property were well kept and in much better condition than the house I was considering buying. You have the power to change the appearance and condition of your house, thereby increasing its value, but as to the neighborhood, not so much. What you have to do is scout potential fixer-upper homes or condos in nice neighborhoods. Look up the property appraiser's website in that area and see the home's sales history. Also, take a look for what the other homes in the area have sold, both in the past (five-plus years) and currently (less than five years). Visit the property, and take a camera with you. Take a picture of every little defect you can find, and make notes about that defect. Estimate what the repairs to all those defects would cost. If the number is not high, then you are not looking at a fixer-upper. My definition of a fixer-upper is a property that by inspection you can document enough needed repairs to justify a below market offer. When you find the right house, deduct the cost of the repairs from the lowest comparable sales or the asking price, whichever is less, and make an offer. Include the detailed breakdown of all the repairs needed. By choosing a fixer-upper, you are choosing a house that most people would not consider buying and most would walk away from without making an offer, which means that you do not have much competition and the owner is most likely to entertain your offer. If you end up buying the house, you have automatically increased your net worth. You will have bought a house far below market value and taken the time to slowly but consistently upgrade it while keeping your mortgage payments much lower than those of your neighbors. Once you are done with all the repairs, you should have equity in the house, at least equal to the amount of repairs you used to bring it to good condition, and then some.

Banks and Credit Unions

Since the crash of the housing market caused by questionable lending practices, it has become difficult to secure a loan from a bank, regardless of the reason. As with buying a home, you must have very good or excellent credit and show consistent income plus a positive net worth. Banks look at your balance sheets, profit and loss statements, and at least two years of corporate tax returns. They typically lend up to 20% of your gross yearly revenues and look to see that your monthly profits will cover the minimum monthly payments along with having a positive net worth. Refer to Chapter 10 in the section on office management for more information on these reports. If you do happen to be in a position to qualify for a small business loan, you should research before choosing your bank to make sure that it has terms best suited for your financial needs. Sometimes credit unions offer better rates or terms to members than banks. Don't be afraid to ask friends in the banking industry for advice on how to best secure a loan.

I tried numerous times to obtain a small business loan to no avail. The housing crash was fresh in everyone's mind, and the banks just were not lending. It was not until I decided to call a good friend from college that I got that opportunity. Even then, the rate was a bit higher than average, and I had to put up a second mortgage on my house. I have also used an equity line of credit on one of my residences after I bought at below-market value and did some repairs and upgrades. This method is by far one of the most difficult forms of start-up funding, unless you have some help from family or friends.

Borrowing from Your 401(k)

If you did as suggested in the previous section and invested as much as you could afford into your 401(k) account, that account might be a great source of start-up funds for you. You do not want to withdraw the funds directly, as this step would cause accelerated taxation and early distribution penalties up to 20% or more of the amount withdrawn. What you want to do is establish your own company retirement plan with the ability to take out loans for whatever reason (subject to laws and local requirements). Then, once you have created your own 401(k) account, you want to roll over the entire vested portion of your account into your newly created qualifying account. Once you do that, you can request a loan from your 401(k) account up to 50% of your vested balance or $50,000, whichever is less. Because you would be the plan administrator, you could then set your own terms of repayment and interest. The repayment amount and interest would be deposited back to your own account. As the laws dealing with retirement accounts vary and change frequently, you should consult an accountant before starting this process.

If you have a working spouse, I hope that you would have advised him or her to do the same, investing heavily in his or her company 401(k), and his or her account may also be a great source for start-up funds.

This was one of the primary forms of start-up funding that I used to start my company. I had contributed as much as I could into my 401(k) plan in my years with my prior two employers. I used money that I had saved up to get the company off the ground, and then I quickly set up and implemented a 401(k) plan of my own for the company. As soon as the plan was up and running, I requested a rollover of 100% of my balance into my own plan. When I structured the plan, I did it so as to allow loans to all participants for whatever reason without restriction, except those governed by law and plan limitations. Not only did I use a portion of my 401(k) savings, which I took out as a loan to start my own business, but I also advised my wife to invest heavily in hers as well. Therefore, we were able to use some of her funds by way of a loan against her account to supplement and ensure our success during tough economic times. The beauty of funding a company in this manner is that the loan application, terms, interest rate, and repayment method are all controlled by you as the plan administrator. In addition, and even better, all the payments, including interest, are deposited back into your own account.

Small Business Administration Grants

The federal Small Business Administration offers support, including loans, to qualifying companies. You should look into its website, along with other sites that offer assistance to technical start-ups. For more information on the U.S. Small Business Administration, you can visit the website at www.sba.gov.

Investors and/or Partners

Seeking investors and/or partners in your company is an option, but these two options, in my opinion, should be explored only after careful consideration and absence of other funding methods. A relationship with an investor or a partner is similar to a relationship with a spouse. There is a good chance that it could end in a messy "divorce" if not handled properly. Make sure that you put all agreements and understandings in writing, regardless of your friendship or trust level with your potential investor or partner. Discuss and document your work philosophy, and provide clear expectations and scope of responsibilities before committing to work together. Remember that having an investor or partner limits your control of the company. I highly suggest, if a partner is the direction you wish to take, that you make sure to maintain controlling stock interest in the company to safeguard yourself from a potential deadlock. Having a partner or investor also limits the tax strategies available to you to position your company in the best manner possible come tax time. You can read more about the tax strategies in the section on profit management in Chapter 10.

When I launched my firm, I had no intention of seeking partners or investors. It would be my company, and I would run it as I saw fit. However, I needed to find a qualifier for the company, and during my search an interesting opportunity presented itself. A colleague and former coworker, who happened to have a P.E. and a tremendous amount of experience in my field, reached out to me. I was hesitant, but we decided to give it a try and team up. Because I had already completely set up the company and had done most of the setup work and had an initial client base, I insisted on keeping 51% of the company and offering my partner 49% of the company but an equal share of the profits. After a few months, it became apparent that we had different philosophies. We started to disagree on the use of the office space, company purchases, workload, and tax benefits. Needless to say, it ended up not working out, and it took me a while to recover and get the company back on its feet. It would have been much worse if I had agreed to a fifty–fifty partnership.

Credit Cards

This should not be your primary source of funding. However, it can provide you with much-needed funds to get you through tough times. It is critical that you actively maintain excellent credit. Without excellent credit, you can forget about this as an option. If you do have it and can maintain, excellent credit, some cards can offer you as much as a $30,000 line of credit, many with introductory low or zero-percent interest rates for a period of time.

I have certainly used credit cards to my advantage when I had excellent credit. I routinely transferred balances from cards with higher interest rates to those that offered low introductory or promotional rates. That all ended, however, when I made the mistake of letting my credit slip. The importance of establishing and maintaining excellent credit cannot be overestimated.

Step 4: Find Out How to Get the Money You Need

Create and stick to a personal budget and establish a goal-oriented financial plan. Being a successful entrepreneur requires a special tenacity, state of mind, and philosophy. It is not easy. If it were, everyone would own their own businesses. In order to understand the entrepreneurial philosophy, I would recommend reading the book by Robert Kiyosaki, with Sharon L. Lechter, CPA, *Rich Dad, Poor Dad*. It was instrumental in helping me understand the financial entrepreneurship philosophy. You will never achieve your financial goals by saving money away, incurring liabilities, or working for someone else. You must learn to invest and/or convert the money you have and the future money you will earn into assets that will create more money for you in the future, whether it is in the stock market, real estate, or in an entrepreneurial venture. You must take educated risks. Learn to use other people's money through loans to make more money for yourself or purchase appreciable assets that can be used for funding your start-up company in the future. You must constantly be thinking of ways to improve your net worth.

The first thing you need to do, once you have established how much money you have, how much money you need, and where to get the money you need, is to determine how much money you *actually* need (Step 2 minus Step 1). The actual money you need are determined by subtracting your estimated start-up funding total from Step 2 (using the three- or four-month reserve amount) from how much money you currently have from Step 1.

The second thing you need to do, once you have determined how much money you actually need, is to write that figure down and set a plan, using the section on where to get the money you need (Step 3) to secure that funding. This step is done by setting goals and creating and sticking to a personal budget for yourself. You can then use the budget surplus to reduce the amount of start-up funding you actually need. With respect to creating a budget, you will not yet have a company; therefore, you will need to create a personal budget using the same principle as that shown in Step 2, but instead using your personal expenses and current income as per Step 1. You must stick to your budget and spend as little as possible on unnecessary expenses, so that you can take the budget surplus and use it to invest in appreciable assets or an entrepreneurial venture instead of letting it sit in a savings account.

Aside from the sources of start-up funding mentioned in Step 2, there are other forms of investment to help you achieve your financial goals: the stock market, real estate, collectibles, antiques, jewelry, loans, and entrepreneurial ventures.

The Stock Market

You should not invest in stocks directly if you do not know what you are doing. However, with proper research or professional advice, investing in the stock market (stocks, bonds, and mutual funds) can be quite lucrative, provided that you follow the old adage of buy low and sell high. Unlike with investing in stocks within a qualified retirement plan, you will be using after-tax money (money you receive from your salary once all applicable taxes have been withheld) to invest, and you will be taxed on your gains. The younger you are, the more you should focus on high-yield, high-risk funds, depending on the market conditions. If the stocks rise greatly, sell off some and place the proceeds in a safer, low-risk, low-yield stock until the stocks begin to drop. Once stocks drop below the point at which you bought them, you can reinvest in those same stocks and ride the eventual wave back up. You will need to do your research or seek advice from a qualified professional, and you have to be patient and understand that investing in stocks is a long-term strategy.

You would be surprised how most people ignore such an easy stock investment strategy as buy low, sell high. Contrary to that rule of thumb, most people tend to get into the market when they see that it is going well and everybody is investing in the market, and they get out when they see that it is going badly and everybody is jumping ship. Because the stock market's historical performance is composed of high cycles and low cycles, if you get into the market when it is high, there is nowhere to go but down, and vice versa, if you get out when it is low, there is no way to recover your losses. Buy low, sell high!

Real Estate

It is important when purchasing real estate as an investment to know what it takes to find a good value. A good value is buying a property at below-market value that with cosmetic changes can appreciate in value in a relatively short period of time. These types of properties include fixer-uppers, distressed properties, and foreclosures. For more information on investing in real estate as your own home, refer back to Step 2 in the section on fixed-asset equity, and Chapter 4 in the section on looking to buy your first house wisely.

Collectibles, Antiques, and Jewelry

If you purchase appreciable items, such as precious stones, gold, silver, collectibles, and antiques, given enough time those investments will increase in value and may serve as a source of funding or reserve for your future company.

Loans

Using loans, not for pleasure or material liabilities (bad loans), but for the purpose of reinvesting or purchasing assets (good loans) is a good way to use other peoples' money to make money for yourself. Make sure that the return that you will get on the investment you choose to use the loan proceeds on is higher than the interest rate you will be charged, including closing costs on the loan.

Entrepreneurial Ventures

Investing in supplementary business ventures for the sole purpose of creating start-up funding or using it to achieve your financial goals is relatively easy to do if you have a specific skill. These goals can be achieved on a part-time basis or as a full-fledged venture. Examples include tutoring, babysitting, and lawn care. Use whatever special skill you may have, or learn one, to help gain capital to put toward your company start-up funds.

Recommended Activities

1. Determine your net worth and available assets.
2. Research your start-up expenses.
3. List your available sources of funding.
4. Set financial goals.
5. Prepare a budget.
6. Invest your money wisely.
7. Inquire into the rollover procedures of your previous employers' retirement accounts.
8. Review the available equity in your current home.
9. Research available federal or state grants or small business loan opportunities.

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