# Frequently Asked Questions about Small Business Finance

This document sketches the ecosystem or life-cycle of small business financing. The FAQ format allows users to browse through topics and learn about specific issues. Small businesses, which include startups in such sectors as information technology, service, retail, and manufacturing, have varying financial needs. The answers provided here represent averages or totals that can be used as figures and trends for differing types of firms. For further small business data and research information, visit the Office of Advocacy's website at www.sba.gov/advocacy/847.[1]

## General small business finance

### What are the main reasons small businesses seek financing?

Small businesses borrow for four principal reasons: for starting the business, purchasing inventory, expanding the business, and strengthening the financials of the firm. Firms choose different means of financing depending on the intended purpose.

### What types of funding do entrepreneurs and small firms use to finance their ventures?

Financing falls into two categories: **debt** and **equity**. Table 1 shows the sources and types of financing available to entrepreneurs. Some of these sources are unusual or unconventional. In addition, when a small business obtains a government procurement contract, it can play a similar role as traditional financing, providing the spark and fuel that are needed for the firm to grow.

### How big is the small business financing market?

Small businesses' borrowing amounts to about $1 trillion. In 2010, the most recent year we have data for, total small business bank loans outstanding were

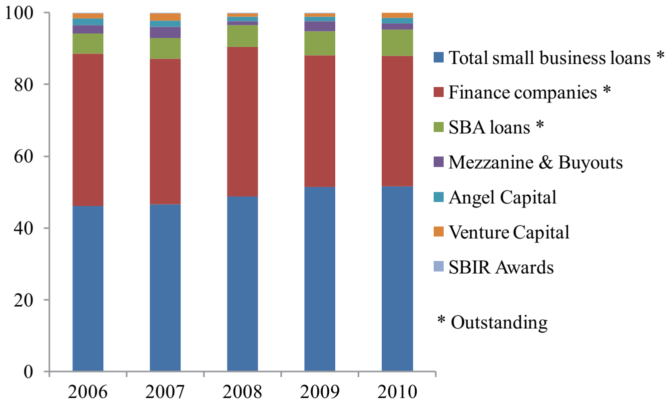
**Table 1. Types of Capital by Source**

| Category | Source | Type |
|---|---|---|
| **Debt** | Owner(s) | Loans, bootstrapping |
| | Institutional lenders (banks and other depository institutions, nondepository institutions, mutual funds, pension funds, insurance companies, investment banks) | Loans, lines of credit, leases, credit cards |
| | Business associates | Loans, credit |
| | Vendor financing | Trade credit |
| | Family and friends | Loans |
| | Peer-to-peer lending | Loans |
| | Crowd funding | Loans |
| | Leasing companies | Loans, capital leases, equipment |
| | Brokerage firms | Loans, lines of credit |
| | Finance company and/or factoring | Trade credit |
| | Government | Loans (and loan guarantees) |
| | Private debt placement | Bonds |
| **Equity** | Owner(s) | Founder's capital, savings, shares |
| | Family and friends | Deposits, shares |
| | Public offering markets | Stocks |
| | *Government:* | |
| | Small Business Investment Company (SBIC) | Shares/ownership stake |
| | Small Business Innovation Research program (SBIR) | Grants |
| | Small Business Technology Transfer (STTR) | Grants |
| | *Private equity placement:* | |
| | Angel investors | Ownership stake, promissory notes |
| | Venture capitalists | Ownership stake, promissory notes |
| **Hybrid** | Mezzanine | Loans and/or ownership stake |

Source: U.S. Small Business Administration, Office of Advocacy.
Note: For definitions, please see the glossary at the end of the FAQ.

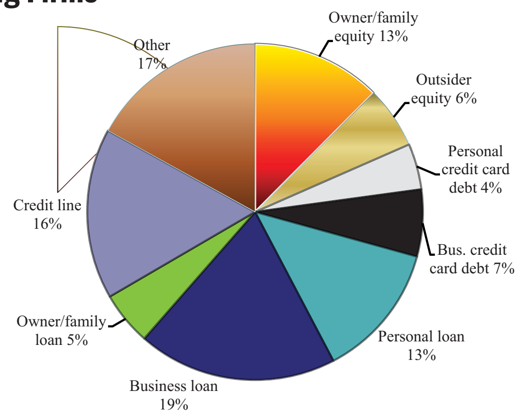
1. The data sources cited here tend to differ widely, probably because of the differing subgroups of businesses that they cover. For instance, data from the Census Bureau's Survey of Business Owners reflects all businesses, while data from D&B reflects a smaller pool dominated by older and larger businesses. This can make this FAQ seem choppy and at times inconsistent. The bottom line is that there is often no perfect data source for many of the questions.

Figure 1. Share of Financing by Category (Percent)




Note: Total small business loans are defined as all loans outstanding under $1 million, including SBA loans; SBA loans were measured as the amount outstanding at the end of the fiscal year. Finance company lending consists of all business receivables outstanding. Note that with dollar amounts being outstanding, the figures are greater than annual small business financing.

Figure 2. Share of Small Business Financing Dollars for Young Firms




Note: Firms started in 2004, reporting 2008 financing and about one-third did not use capital in the year. Source: U.S. Small Business Administration, Office of Advocacy, from data provided by Kauffman Firm Survey

valued at $652 billion, and finance companies provided another $460 billion worth of credit. All other sources combined made up around 10 percent of small business borrowing (Figure 1). The recent decline in finance company lending (another source of small business loans) is a major contributor to the tight condition of today's small business lending market. Total small business loans outstanding and SBA loans outstanding in 2010 are above 2006 levels

### What share of small businesses use financing?

The answer to this question depends on whom you ask. According to the Kauffman Firm Survey, one-third of young firms do not use capital injections. Instead they rely on owner investment or nonbank sources of funds. A Census Bureau dataset finds that over half of existing firms do not need expansion financing. This reflects the fact that many businesses are not growth businesses; they reach an optimal size and stay that way. And some businesses are structured so that they self-finance. (These two sources draw from different sample pools; the Kauffman pool has a larger than average business size; the Census set includes very small businesses and its average size more closely approximates the national average.)[2]

### How are small businesses financed?

For businesses that depend on financing, the two most widely used sources are owner investment and bank credit.

In their early years, young firms make heavy use of the external debt market, receiving about three-quarters of their funds from banks via loans, credit cards, and lines of credit (Figure 2). The bulk of small business financing dollars comes from business and personal loans. Outside equity, such as angel investment and venture capital, amounts to 6 percent of financing for young firms.[3]

The U.S. Census Bureau dataset confirms the importance of owner investment and bank loans, especially for employer firms (Figure 3). While the two principal financing data sources differ somewhat, similar patterns emerge from both: savings matter and bank credit matters for an important share of businesses. In addition, a significant number of established businesses do not use financing.

### How are startups financed?

The Kauffman Firm Survey found that startup capital for small businesses is composed of debt and equity capital, and it averages roughly $80,000 a year per new firm. Startups depend about equally on the owners' cash injections into the business and funds from bank credit (Figure 4).[4] The most frequently used source of startup dollars was owners' and relatives' savings. The U.S. Census Bureau found that about one-third of new nonemployer firms and 12 percent of employer firms used no startup capital (Figure 5). As expected, employers made greater use of financing than did nonemployers.

### What is the dollar distribution of startup financing?

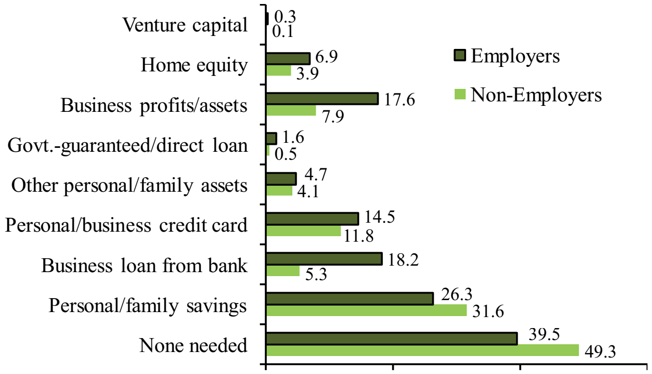
The median startup capital used by new employers is about $50,000, and by new nonemployers, $25,000. However, a large share of startups commence business operations with very little capital. A relatively large share of employers and nonemployers used less than $5,000 worth of startup financing (20 percent and 39 percent, respectively) and another sizable share did not use any startup financing (10 and 25 percent respectively). See Table 2 and Figure 5 for details.

2. The large share of businesses that use no financing is reflected in general business surveys that rank financing low on the list of pressing business concerns. Of course, for the select group of firms for whom financing is a critical need, not being able to obtain it has profound implications for their ability to expand. See National Federation of Independent Business, *Small Business Economic Trends,* www.nfib.com/research-foundation/small-business-economic-trends-sbet-archive.

3. Alicia Robb, E.J. Reedy, Janice Ballou, David DesRoches, Frank Potter, Zhanyun Zhao, *An Overview of the Kauffman Firm Survey: Results from the 2004–2008 Data,* Kauffman Foundation, May 2010. Note that results based on the Kauffman Firm Survey are based on a sample pool of businesses that are larger than the national average.

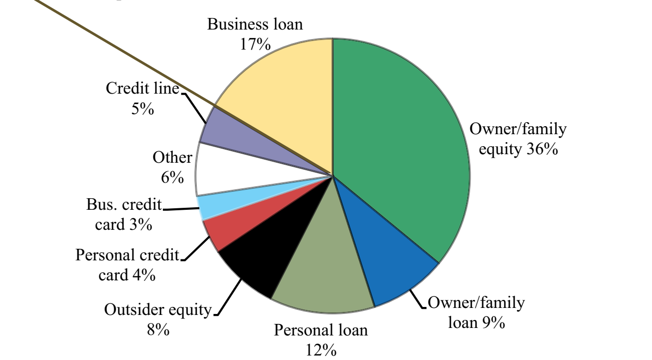
4. Alicia Robb et al., *An Overview of the Kauffman Firm Survey: Results from the 2004–2008 Data,* Kauffman Foundation, May 2010.

**Figure 3. Percent of Firms Using Expansion Financing**



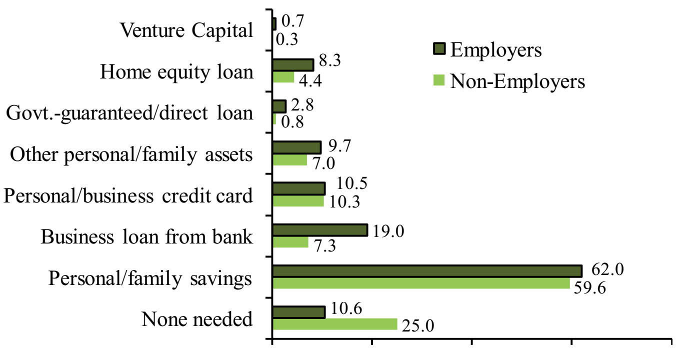

Note: Firms in existence in 2007.
Source: U.S. Small Business Administration, Office of Advocacy from data provided by the U.S. Census Bureau, Survey of Business Owners.

**Figure 4. Share of Small Business Financing Dollars for Startup Firms**




Note: Firms started in 2004 and about one-tenth did not use capital to start.
Source: U.S. Small Business Administration, Office of Advocacy, from data provided by Kauffman Firm Survey

**Figure 5. Percent of Firms Using Startup Financing**




Note: Firms in existence in 2007.
Source: U.S. Small Business Administration, Office of Advocacy from data provided by the U.S. Census Bureau, Survey of Business Owners.

**Table 2: Level of Startup Capital by Firm Size (Percent)**

| | Employers | Nonemployers |
|---|---|---|
| All firms | 100.0 | 100.0 |
| Less than $5,000 | 20.3 | 38.7 |
| $5,000 to $9,999 | 9.6 | 9.1 |
| $10,000 to $24,999 | 13.1 | 8.5 |
| $25,000 to $49,999 | 10.2 | 5.0 |
| $50,000 to $99,999 | 11.5 | 4.1 |
| $100,000 to $249,999 | 11.8 | 3.6 |
| $250,000 to $999,999 | 7.9 | 2.4 |
| $1 million or more | 3.0 | 1.1 |
| Not applicable | 12.6 | 27.6 |

Note: Figures recalculated to account for "don't know" responses.
Source: U.S. Small Business Administration, Office of Advocacy from data provided by the U.S. Census Bureau, Survey of Business Owners.

## How much do small businesses rely upon credit cards?

Credit card financing accounts for a small portion of small business capital; roughly 7 percent of all startup capital is derived from credit cards (includes personal and business credit cards). On the other hand, credit cards are very widely used. A recent study by the National Small Business Association shows the percentage of small businesses using credit cards tops all other financing choices. In a tight credit market small firms' use of credit card financing is likely to increase, especially for business expansion. Small business owners are more likely to carry credit card debt than other households (54 percent versus 45 percent respectively). With small businesses relying about half on personal credit cards and half on business credit cards, the personal credit cards would be affected by the Credit Card Act of 2009.[5]

## How are franchises financed?

Existing employer franchises finance expansion using the same financial tools as other businesses, but startup franchises are more likely to use a commercial bank loan. (37.8 percent of franchises versus 23.1 percent of all employer startups used a bank loan.)[6]

## How are veteran-owned ventures financed?

Veteran-owned businesses were extremely similar to other businesses in their use of credit for startup and expansion. For example for expansions, 11 percent of veterans used credit cards and 8 percent used bank loans while the figures were 13 percent and 9 percent, respectively, for all firms.[7]

## How are women-owned ventures financed?

Women are more likely than males to start businesses without seeking financing (Figure 6). Women-owned businesses (just like their male counterparts)

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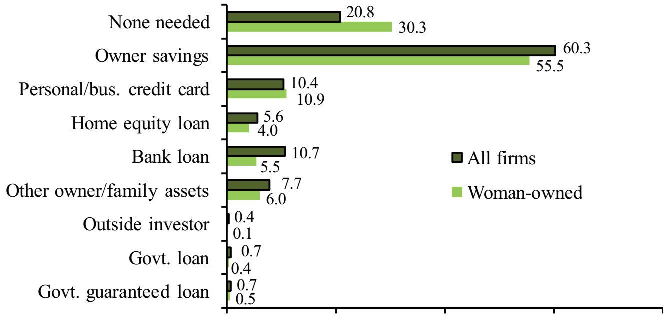
5. 2009 Small Business Credit Card Survey, www.nsba.biz/docs/09CCSurvey.pdf. George Haynes, *Structure of Household Debt of Small Business Owners in the United States: Findings from the Survey of Consumer Finances, 1998–2007,* Office of Advocacy, June 2010.

6. Brian Headd and Radwan Saade, *Do Business Definition Decisions Distort Small Business Research Results?* Office of Advocacy Working Paper, August 2008.

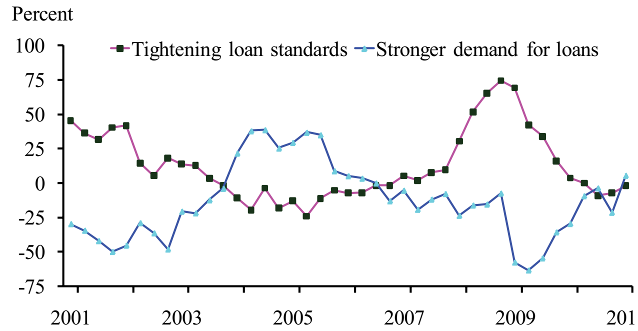
7. The data on veteran-, woman- and minority-owned firms used here come from the U.S. Census Bureau, Survey of Business Owners.

**Figure 6. Types of Financing used by Woman-Owned Startups (Percent)**



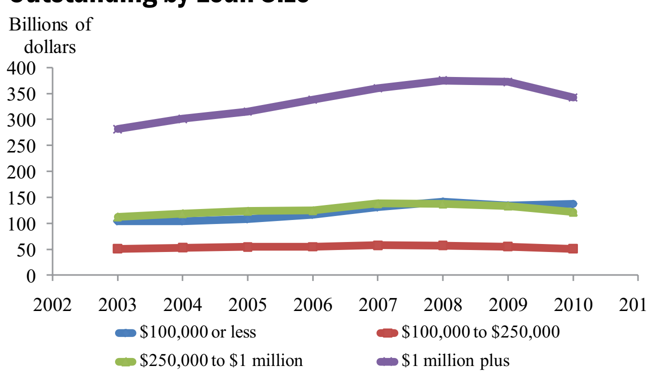

Source: U.S. Small Business Administration, Office of Advocacy from data provided by the U.S. Census Bureau, Survey of Business Owners.

**Figure 7. Small Business Bank Lending**



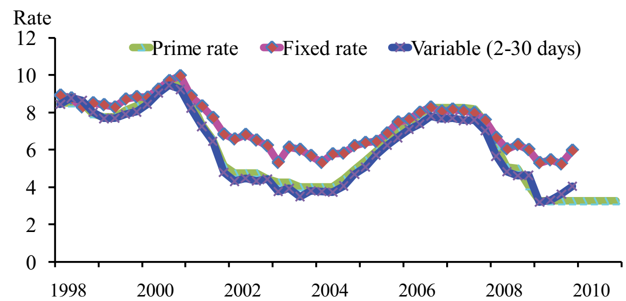

Note: Change in percentage of respondents from the previous period. Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Federal Reserve Board Senior Loan Officer Survey.

**Figure 8. Commercial and Industrial Loans Outstanding by Loan Size**




Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Federal Reserve Board Call Report data.

**Figure 9. Small Business Interest Rates (Loan size $100,000 to $499,000)**




Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Federal Reserve Board, Survey of Terms of Lending.

largely depend on personal finances; they are more likely to use credit cards to fund their businesses. And women are almost half as likely as male-owned businesses to obtain business loans from banks. This puts women-owned businesses at a disadvantage, because a business's relationship with a bank at the outset not only provides funds, but often provides business advice and future goodwill.

### How are minority-owned ventures financed?

At startup, Hispanic-owned firms are less likely than other business owners to have bank loans. Firms owned by Hispanic-Americans, African-Americans, and Asian-Americans were more likely to rely on credit cards at the outset. When expanding, Hispanic-owned firms and African-American owned were more likely to rely upon credit cards than other firms. This heavier-than-average reliance on credit cards negatively affects a business by displacing a personal relationship with a bank, which is often the source of less costly financing that is tailored to a business's needs.

### How does the debt held by small business-owning households differ from other households' debt?

Small business-owning households held 59 percent of their debt in mortgages, versus 38 percent for other households. They were even further dependent on real estate as they held another 7 percent of their debt in residential secured debt.[8] This dependence on real estate illustrates the double storm that small businesses have weathered in the last few years of declining real estate values and tight credit in financing their businesses.

## Current environment

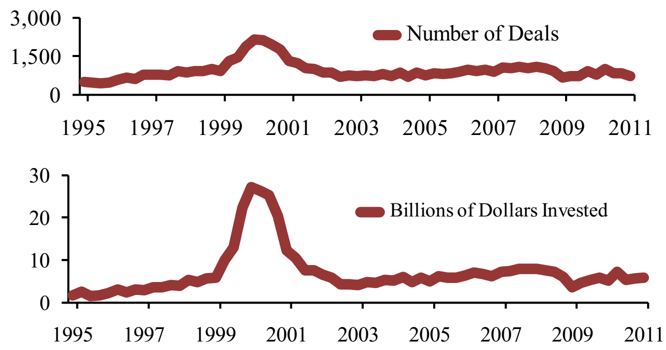
### What is the current lending environment for small businesses (as of August 2011)?

Credit conditions in the small business market continue to remain tight, even though commercial banks began easing lending conditions in mid-2010 (Figure 7). Billions of dollars outstanding for all loan sizes are down from pre-recessionary levels. But bank loans under $1 million held relatively steady during the downturn, while larger loans ($1 million or more) saw a pronounced decline (Figure 8).[9]

8. George Haynes, *Structure of Household Debt of Small Business Owners in the United States: Findings from the Survey of Consumer Finances, 1998–2007,* Office of Advocacy, June 2010.

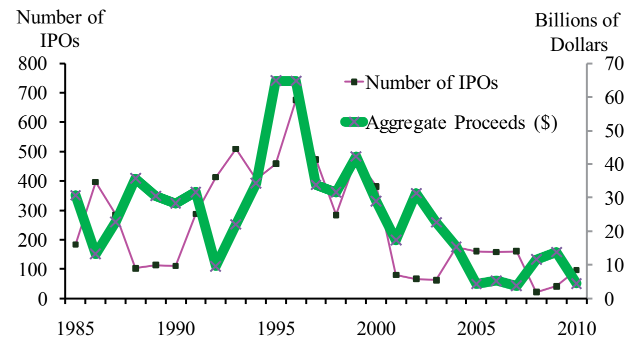
9. Federal Reserve Board, Senior Loan Officer Opinion Survey and Call Report data.

**Figure 10. Venture Capital**




Source: Office of Advocacy, U.S. Small Business Administration from data provided by PricewaterhouseCoopers/National Venture Capital Association using Thomson Reuter data.

**Figure 11. Initial Public Offerings**




Source: Office of Advocacy, U.S. Small Business Administration from data provided by Prof. Jay R. Ritter, University of Florida.

### What interest rates are small businesses typically charged for loans?

Fixed interest rates on loans between $100,000 and $499,999 have been 6 percent while short-term variable rate loans (2-30 days) have been about 4 percent (Figure 9). While interest rates are near their lowest point in a decade, in 2009 the spread between the prime rate and the variable interest rate increased; this represents a perceived risk in small business lending not seen in the previous downturn around 2000. Interest rates on credit card balances vary widely.

### What is the status of the venture capital market?

The venture capital market is down substantially in both deals and dollars from the bubble of 1999-2001 (Figure 10). More importantly, the steady growth in deals and dollars that existed in the late 1990s has not resumed. The venture capital markets have been flat for nearly a decade since the bubble burst. However, venture capital is also about 30 percent below pre-recession levels in the number of deals and dollars.

### What is the status of the initial public offering market?

While the number of initial public offerings (IPOs) has risen since 2008, the 2000s could be considered a lost decade of IPOs; their number and value relative to the 1990s declined significantly (Figure 11). The IPO market has been on a roller coaster ride over the past two decades; a healthy IPO market is probably in the range of 250-350 deals per year, a level which has not been seen since 2000. The trends in aggregate proceeds seem to mirror the trends in the number of IPOs although one could argue that dollars have lagged listings by a few years (Figure 11).

### What is the condition of the angel capital market?

Accredited investors, also known as angels, are investors who are qualified based on federal securities laws. The angel market was down in 2008 and 2009, but was revived in 2010 with increases of 14 percent in dollars invested and 8.2 percent in the number of entrepreneurial ventures that received angel funding. But the angel market for seed and startup capital continues to contract as angels shift their preference to later-stage investments (post-seed/startup investments).[10]

### How did the downturn affect business lending by large and small banks?

Large bank lending tends to follow the business cycle while smaller bank lending tends to be relatively steady. Banks with $50 billion or more in assets had solid increases in their commercial and industrial lending (outstanding) from 2003 to 2008 and had declines in 2009 and 2010 because of the downturn (Figure 12). Most other bank sizes had relatively flat lending trends during this time period, with the exception of the smallest banks. Lending at these banks (with less than $100 million in assets) has been in a long-term declining trend. While smaller banks might be seen as a shock absorber for small business financing during a downturn (since their lending held steady), their minimal growth in lending over nearly a decade could also be an indicator of their waning ability to be a small business resource.

### What is the approval rate of small business loans?

In the first quarter of 2010, Biz2Credit reports that slightly less than half of all small business loans were approved (www.biz2credit.com).

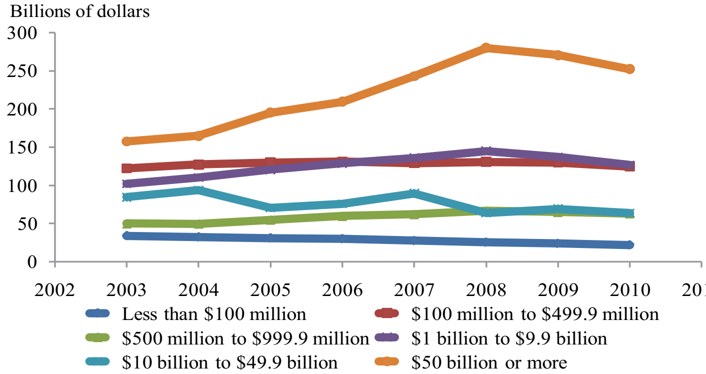
## Government financing

### What are SBA loans?

SBA loans are government-backed loans available through commercial lenders which follow SBA's guidelines. Except for the disaster loan program (www.sba.gov/taxonomy/term/99), the SBA does not make direct loans to small businesses. SBA works with lenders to provide a partial guarantee for loans. In essence, SBA acts like a co-signer for small businesses who often lack collateral or a credit history. SBA's partial guarantee reduces the risks for lenders, increases lending to small business, and allows small businesses to expand economic activity. From a policy perspective, SBA's costs for such programs are loan

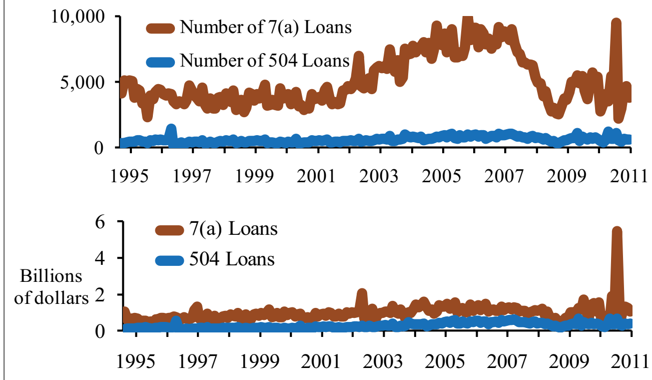
10. University of New Hampshire, Whittemore School of Business and Economics, Center for Venture Research.

## Figure 12. Commercial and Industrial Loans Outstanding By Bank Asset Size



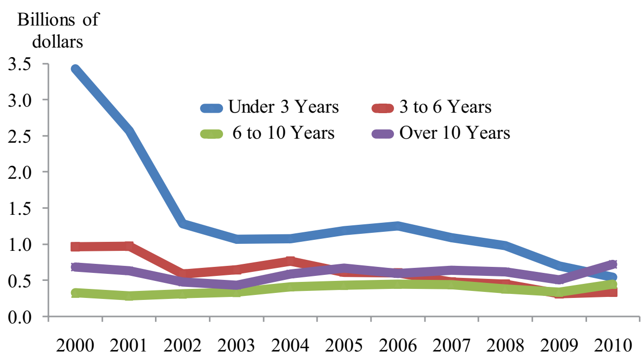

Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Federal Reserve Board CRA data.

## Figure 13. SBA Loans



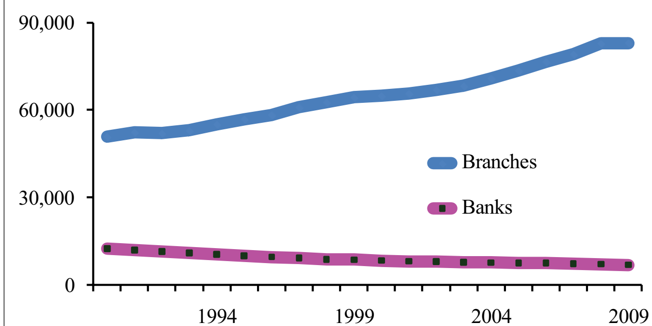

Source: U.S. Small Business Administration.

## Figure 14. SBIC Funding by Age of Firm




Source: U.S. Small Business Administration.

## Figure 15. Number of Lending Institutions




Source: Office of Advocacy, U.S. Small Business Administration from data provided by the FDIC.

losses minus fees, not the entire amount that SBA guarantees, as loans are to be repaid. For more information about SBA loan programs, see www.sba.gov/category/navigation-structure/loans-grants/small-business-loans.

### How has the business cycle affected SBA loans?

While the economic downturn has substantially affected the number of SBA loans, the dollar amount has changed less. In some ways SBA loans are a shock absorber in times when credit is tight, but even this program is not immune to the economics of decreased loan demand in the peak and nadir of a downturn. Making the data difficult to interpret is the fact that SBA guarantees and fees have changed over the years; this creates various pullbacks and surges in the SBA loan program such as the spike in lending at the end of 2010 (Figure 13).

### Can a small business obtain financing after a natural disaster?

Depending on the viability of the small business in the aftermath of a natural disaster, the SBA may be able to make a direct low-interest, long-term loan to repair physical and economic damage caused by a declared disaster. For details see www.sba.gov/category/navigation-structure/loans-grants/small-business-loans/disaster-loans.

### What are Small Business Investment Companies and whom do they fund?

Small Business Investment Companies (SBICs) are privately owned and managed investment funds, licensed and regulated by SBA. SBICs combine their own capital with SBA-guaranteed funds to make equity and debt investments in qualifying small businesses.

Small businesses can seek funds from SBICs at different stages of development, but note that at the beginning of the decade SBICs were more likely to fund startups, and have shifted to mature companies in recent years (Figure 14).

### Are there other federal government programs for small businesses?

Yes, one such program is the Department of Agriculture's B&I Guaranteed Loan Program, whose structure is similar to SBA loan guarantees. For details see www.rurdev.usda.gov/rbs/busp/b&i_gar.htm. The Department of Treasury's Community Development Financial Institutions Fund also helps promote access to capital in urban and rural low-income communities (www.cdfifund.gov).

Two additional programs, Small Business Innovation Research (SBIR) and Small Business Technology Tranfer (STTR), offer research and development grants and contract opportunities targeted to small businesses.These are perhaps the best sources of risk capital available to fund the development of promising new technologies. SBA does not administer awards, but has the responsibility for directing the participating agencies in the administration of the program.[11]

## Policy issues

### How has the Sarbanes–Oxley Act of 2002 affected small businesses?

The Sarbanes–Oxley Act mainly applies to publicly traded companies with a public float of $75 million and above. Most small businesses are privately held or below this threshold, but the law could require them to be audited if they are suppliers to publicly traded companies. While certain small businesses are subject to the law, the overall small business impact is unclear and is likely to remain so until sufficient data becomes available to evaluate.

### How has bank consolidation affected small businesses?

Bank consolidation affects small business loan markets differently depending on the degree of competition in these markets. Proving how this affected small business lending is difficult because of the uncertainty in developing a scenario where the banks would not have merged at such high rates. And research has shown that the availability of credit to most small firms has not been adversely affected by large bank mergers and acquisitions.12 The number of lending institutions has declined almost 50 percent in the past two decades (Figure 15). A separate, encouraging trend is that the number of bank branches has increased by almost two-thirds during the same period, providing more opportunities for small businesses to maintain local banking relationships.

## Research and data sources

### Where can I obtain small business data on financing?

The U.S. Census Bureau's *Statistical Abstract of the United States* is a good starting point for summary financing statistics (www.census.gov/compendia/statab/cats/banking_finance_insurance.html). Additionally, data aggregators such as the Federal Reserve Bank of St. Louis's FRED (http://research.stlouisfed.org/fred2) and the Federal Government's Data.Gov (www.data.gov) can in some cases provide one-stop data shopping. However, much of the data discussed in the *Stat Abstract* is not related to small business, so most researchers will have to access microdata (i.e., records for individual businesses sans personal information) and/or aggregated business data from the following sources.

The business financing data sources which contain microdata are:

• The Kauffman Firm Survey or KFS (Kauffman Foundation, www.kauffman.org/kfs);

• EDGAR, the Securities and Exchange Commission's database of publicly traded companies (www.sec.gov/edgar.shtml);

• The Panel Study of Entrepreneurial Dynamics (www.psed.isr.umich.edu/psed); and

• The defunct Survey of Small Business Finances or SSBF (Federal Reserve Board, www.federalreserve.gov/pubs/oss/oss3/nssbftoc.htm).

• Note that the Survey of Consumer Finances also contains limited small business financing data (Federal Reserve Board, www.federalreserve.gov/pubs/oss/oss2/scfindex.html).

KFS followed about 5,000 startups in 2004 to 2009 with plans to follow them through 2011. EDGAR has filing information on publicly traded companies. PSED contains about 800 businesses followed from 1998 to 2000 with three follow-ups up to 2006. SSBF contains about 4,000 data points for the years, 1987, 1993, 1998, and 2003. These micro datasets contain a wealth of variables and are useful in determining how various business types are financed and, in some cases, could allow the researcher an opportunity to show their impact on the firm.

Aggregated financing figures contain limited variables but are helpful in showing financing trends through historical data. Data sources publishing aggregate business financing figures include:

• The Senior Loan Officer Survey (SLOS, Federal Reserve Board, quarterly, www.federalreserve.gov/boarddocs/snloansurvey);

• Call Reports (Federal Deposit Insurance Corporation, quarterly, https://cdr.ffiec.gov/public);

• Community Reinvestment Act filings (Federal Financial Institutions Examination Council, annual, www.ffiec.gov/cra/craproducts.htm);

• Initial public offerings (Prof. Jay Ritter, University of Florida, http://bear.warrington.ufl.edu/ritter/ipodata.htm);

• Venture capital statistics (PricewaterhouseCoopers/National Venture Capital Association using Thomson Reuter data, annual and quarterly, www.nvca.org);

• Survey of Business Owners (U.S. Census Bureau, quinquennial, www.census.gov/econ/sbo/02/cbsof.html); and

• Small Business Loan data (U.S. Small Business Administration, weekly, www.sba.gov/category/lender-navigation/lender-loan-data).

Some sources, such as the Flow of Funds report, include small businesses but they are overwhelmed by data for large businesses (Federal Reserve Board, quarterly, www.federalreserve.gov/releases/z1/default.htm).

Although the Office of Advocacy does not endorse them, a few commercial subscription data sources are available and contain microdata. These can be used to gather small business finance information for individual companies or aggregate figures.

11. Federal agencies with annual research and development budgets exceeding $100 million are required to allocate a portion of their R&D budget to these programs. Currently, 11 federal agencies participate in the program: the Departments of Agriculture, Defense, Education, Energy, Health and Human Services, Homeland Security, and Transportation; the Department of Commerce's National Institute of Standards and Technology and National Oceanic and Atmospheric Administration; Environmental Protection Agency; National Aeronautics and Space Administration; and National Science Foundation

12. Charles Ou, *Banking Consolidation and Small Business Lending: A Review of Recent Research,* Office of Advocacy, March 2005.

These sources include:

• ABI/Inform (www.proquest.com/en-US/catalogs/databases/detail/abi_inform.shtml);

• Center for Research in Security Prices (www.crsp.com);

• Compustat (www.compustat.com/compustat_data);

• D&B (www.dnb.com);

• Experian (www.experian.com); and

• Hoover's (www.hoovers.com).

## Unanswered questions

### Frequently asked questions that remain unanswered.

Some questions remain very hard to answer, primarily because of a lack of data. They include:

What is the default rate of small business loans?

Is there a "valley of death" or "capital chasm," i.e., a middle level of financing that is a barrier to growing firms?

How much capital do small businesses receive from finance companies?

How do small businesses spend the financing funds they receive?

How many small business owners have personal guarantees on their loans?

What dollar amount of small business loans do banks charge off each year because of nonperformance?

What is small businesses' creditworthiness, how does it compare to large firms' creditworthiness and how is this affected by the business cycle?

## Additional Publications

*Small Business in Focus: Finance.* U.S. Small Business Administration, Office of Advocacy, www.sba.gov/sites/default/files/09finfocus_0.pdf;

"Financial Services Used by Small Businesses: Evidence from the 2003 Survey of Small Business Finances" by Traci L. Mach and John D.Wolken. Federal Reserve Board, *Federal Reserve Bulletin,* October 2006;

"Women and Men Entrepreneurs: Different Relationships to Bootstrap Finance" by Lynn Neeley and Howard Van Auken. *Journal of Developmental Entrepreneurship*, 2010.

"Five Unique Loan Sources," NFIB. www.nfib.com/business-resources/business-resources-item?cmsid=49178.

## Glossary

**Angel investor.** An individual or accredited investor who provides early stage funding, and are known to invest their own money rather than that of an institution.

**Bootstrapping/bootstrap financing.** The actions of a startup to minimize expenses and build cash flow, thereby reducing or eliminating the need for outside investment.

**Crowd funding.** (Sometimes called crowd financing or crowd-sourced capital.) A collective cooperation of people who network and pool their money and resources together, usually via the Internet, to support efforts initiated by other organizations. While peer-to-peer lending typically focuses on one individual lending to another, crowd funding—as its name implies—aims to reach a funding goal by aggregating many small investors.

**Factoring.** A financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor) at a discount in exchange for immediate money with which to finance continued business operations.

**Loans outstanding.** The unpaid balance on any term loan, installment, revolving or credit card debt on which interest is charged.

**Mezzanine financing.** A hybrid of debt and equity financing that is typically used to finance the expansion of existing companies—the debt capital gives the lender the rights to convert to an ownership or equity interest in the company if the loan is not paid back on time and in full. Mezzanine debt is typically senior to original equity invested in the company, but junior to any bank financing. In essence, the mezzanine financing fills in the gap between the first mortgage held by a bank and the equity contributed by the principal owners of the business.

**Peer-to-peer (P2P) lending**. A lending arrangement in which individuals with little or no collateral seek loans from ordinary people looking to lend (via an online social lending marketplace/network); lenders compete with each other to make loans, often resulting in lower rates for the borrowers.

**Small Business Investment Company (SBIC)**. A company licensed by the Small Business Administration to receive government capital in the form of debt or equity to use in private equity investing.

**Small Business Innovation Research program (SBIR)**. A federal program awarding research and development funds to small businesses to develop and commercialize new technologies.

**Small Business Technology Transfer (STTR).** A federal program fostering innovation by funding small business research and development and developing public/private partnerships among small businesses and nonprofit research institutions.

**Trade credit**. A business-to-business arrangement in which a supplier provides goods and services at one point in time and collects the charges at a later point. Put another way, receiving a discount for paying early is equivalent to being charged interest for paying later.

**Vendor financing**. A loan from one company to another which is used to buy goods from the company providing the loan.

**Venture Capital.** A segment of the private equity industry often investing in high risk/high growth companies with pooled funds, sometimes from large institutions.

### About the Office of Advocacy

The SBA's Office of Advocacy was created by Congress in 1976. Part of the office's mission includes conducting policy studies and economic research on issues of concern to small businesses. The office also publishes data on small firm characteristics and contributions. For further data and research information, visit the Office of Advocacy's website at www.sba.gov/advocacy/847.