

Alternate Financing Options What To Do When Your Bank Says 'No'

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Sometimes, traditional financing does not provide a good fit for a particular project. Insufficient equity contributions, unavailability of personal guarantees from the project developers, or risks associated with an unproven market or concept can all prove to be barriers in accessing traditional forms of funding.

Fortunately, there are other options. These include:

Venture Capital Lenders
Private and Personal Investors

Should I Find A Venture Capital Firm?

Venture capital firms base their existence on generating high margin investment returns for their investment client pools. They do so by analyzing many different financing opportunities and weighing the risk versus return likelihoods of each to arrive at a funding decision. While venture firms are willing to absorb greater levels of risk, they are not willing to overlook risk. The charging of a higher interest rate does not itself warrant the burden of increased risk, and therefore, venture firms will only invest in projects that show strong merits for success. For many years, there was a belief that venture firms would lend money to just about anyone. The truth is that venture firms operate much in the same way as banks; the difference is that they are willing to absorb more risk, particularly with 'start up' or new projects.

The use of venture capital investment dollars can have many drawbacks, including the loss of managerial control, loss of controlling stock interest, or both. Very rarely will a venture firm allow existing management to "steer the ship" unilaterally, and might therefore appoint an operational trustee to approve all decisions. This type of restriction is intended to preserve the venture firm's investment in the business, as most venture-related transactions are dependent upon forward-looking business cash flows, not the value of lien collateral. Still, the use of capital from a venture provider can solve several issues including:

- quicker application turnaround
- potential elimination of personal guarantees from the project's principals
- elimination of prepayment penalties
- ability to heavily leverage project beyond traditional standards

In many cases, the acquisition of venture financing can prove to be quicker than making application to a traditional bank lender. Venture firms often rely on one or two key credit officers than jointly analyze and approve transactions on the part of the investment consortium. By operating in this way, a project's analysis travels through fewer steps, with a decision often rendered within 10-15 days. Traditional bank lenders may extend a credit decision well beyond 30 days, particularly if they feel additional information from the applicant is necessary. While venture approvals typically carry substantially greater interest rates than traditional lenders- sometimes two to three times greater - it is often possible to raise such financing without the project principals providing personal guarantees for the amounts borrowed. At times, this has been enough of an incentive to pay the greater interest rate, particularly if the use of funds is for a short period of time. Short usage is the key, as most new developers typically refinance such borrowings with traditional sources within the first three years of operation. With this in mind, venture firms will generally permit repayment of proceeds at any time without penalty, whereas traditional lenders have increasingly relied upon the existence of prepayment penalties to "lock" their borrowers into the transaction for a defined period of time.

Projects that fail to be accepted by traditional lenders are often rejected because of insufficient equity contributions on the part of the developers. This creates a high leverage condition, whereby the borrowed funds make up all, or substantially all, of the funds needed to complete the project's development. High leverage creates increased risk for the lender, as the lender is then the only party that is holding any significant degree of financial risk. As a rule of thumb, traditional lenders generally expect to see 20-25% of the project costs to be contributed by the development team, with the lending segment holding no more than the remaining 75%. Venture firms offer more flexibility, at times providing 90-95% of project costs in exchange for ownership interests, back-end buyouts, and/or managerial control options. A word of caution: high interest rates and loss of managerial control do not mix well. A venture firm may be heavily focused on preservation of its interest

cash flows (interest payments from company) and capital preservation (of the dollars it has lent), while your focus might be on market share growth and customer service. Naturally, the management team that is in control will generally win this argument. There will always be the proverbial horror stories that tell of unsuspecting developers whose projects have been stripped out from underneath them by the fine print of their venture agreements. While I can't validate that particular situation, I can say that I've witnessed tangles between borrowers and venture lenders that seemed to border on pirating.

Private Investors

Private investors represent another viable alternative to traditional bank financing, and often come in many forms. Private investors include any individual or group of individuals that agree to serve as a lender or partial lender for your project. This might include your next door neighbor, friend of your accountant, members of the local soccer club, or a community real estate developer that serves your area. Individuals in these categories rarely wear a sign on the back of their shirts that say, "I'm an investor", but in many cases, these regular folks prove to be the best 'partners' you can have. For one thing, your entertainment concept will probably be easier to sell to a local individual who understands what the market is made up of, where the competition exists, what local families expect, and how the government machine works throughout the area. The private investor can also be the most forgiving during stressful periods. Unlike banks or venture firms, a late interest payment is more easily handled with a person you can communicate with face-to-face than a portfolio manager who's bonus rests in his ability to keep your payments coming on time. Quite often, borrowing money from private sources can also prove to carry fewer closing costs, as a local attorney can easily draft a loan and or equity agreement between the parties using standardized shelf language. In the end, this can save a tremendous amount of capital that would have been spent on appraisals, lien searches, audit reviews, custom document preparation, and a host of other seemingly simple, but utterly expensive, processes.

There is, of course, a downside in selecting private investors. Perhaps the biggest disadvantage I've observed over the years is one of personal involvement. Many local investors have a tendency to become 'hands on' through their investment relationship. This means that your home phone is ringing in the evening with new thoughts and suggestions that may contradict your own operating plan. Other times, such investors make their way into the entertainment facility at random and begin critiquing staff, changing objectives and procedures, and challenging current programming. When this happens, friction begins to develop between the core developers and the private investors, and often leads to the buy out of agitated investors on a case-by-case basis. So, obtaining a \$500,000 funding investor might seem like a great find this year, but by next year you might be painfully searching for replacement capital to get the monkey off your back.

To sum up the three forms of financing, here's a quick snapshot of common practices:

Lender Type	Speed Of Response	Lending Restrictions	Interest Rate	Stock Interest	Personal Guarantee	Loan To Value Ratio
Traditional Banks	slow	moderate	6-8%	no	yes	75% max
Venture Firms	medium to fast	high	12-16%	yes	sometimes	95% max
Private Investors	fast	low	10-12%	sometimes	no	up to 100%

So, when it's time to start shopping, think carefully about your objectives, the financial capabilities of your project, and your ability to maintain control of the operation. Choose the method of financing that most appropriately meets the majority of your criteria and always be prepared to negotiate a transaction that you can live with for the long haul, not just one that gets the doors open. Until money begins growing on trees, we all have to rely on financing at one time or another. Armed with the right information, you can fund just about any type of project or creation. The key is to do it with your eyes wide open and your hands firmly on the wheel.

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