Emerging companies

FINANCE OPTIONS

STRAPPED FOR CASH

Savings and cash from personal mortgages most often fund business start-ups. **Report: Jessica Gardner**

Empty handed: Banks are reluctant to fund start-up businesses

IN A NUTSHELL

- Without offering security, such as property, founders of start-up companies are unlikely to get bank funding.
- Many founders are reluctant to offer equity in the early stages, so private equity and public raising are rarely used.
- Founders who put up their own savings, or mortgage personal property to fund a start-up find that these options drive them to succeed but often can mean companies are initially under-funded.

Brad Fullin remembers the frustration of going from bank to bank for between six to 12 months, looking for funding for his residential construction company Palladio Homes. He kept "hitting a brick wall".

Fullin says he had been tarnished by too many companies going broke his industry and the banks didn't take him seriously. In the end, he took $50,000 from the mortgage on his house. He felt it was the only avenue open to him.

"No one's interested in lending to a start-up company," Fullin says. "That's why we just looked at mortgaging what assets had."

Other options, such as private investors, didn't suit him. Fullin owns Palladio equally with his wife Linda. "We just wanted it to be ourselves," he says. "I didn't want anyone else to be telling me what to do."

Fullin's story is not unique. Only 3 per cent of the companies on the *2011 BRW Fast Starters* list – born on the eve of the global financial crisis – sourced initial capital from banks (see table).

Overwhelmingly, the capital source of choice was savings (68 per cent) but many entrepreneurs bet the family home on their big idea, with 15 per cent drawing cash from their mortgages.

The managing director of Irizar Oceania, an exclusive distributor of Spanish bus and coach bodies, Tony Fairweather, drew from about $200,000 of savings to start the business with his father Warren.

"We were lucky that we were in a position to fund this period through our own savings," Fairweather tells *BRW* in an email. "I had a personal objective to be debt free during the first three years of operation."

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Brad Fullin, Polladio

He says he had low overheads in the beginning and "always knew we had credit cards to fall back on".

For capital intensive businesses, it may seem inconceivable but 19 per cent of the Fast Starters began operating with less than $5000. Andrew Yang started Synergy Enterprise, using only credit cards (the third most popular option, used by 13 per cent of companies). The business, which is a parent company for e-commerce website The Storehouse and online focused marketing agency Exodus Interactive, was born out of necessity.

Yang's previous employer, a creative agency, was in financial trouble and offered him use of the company's office at no charge for six months as part of a redundancy package. Yang began designing websites for small and medium enterprise clients. Although Yang says his small starting capital was enough, he did have to tell his staff at first there would be a delay in their pay.

"I told them if you want to stay on, stay on but I'm not going to hold anyone to it," he says. "They all stayed on ... we haven't looked back."

Yang, whose business turned over more than $700,000 last financial year, does have advice for entrepreneurs going the credit card route. "Get your credit card before you go into business, while you're still an employee," he says. "It's now much harder to get approvals when you're self-employed."

Also starting his business from the "less than $5000" bracket, was Llew Jury, managing director of Reload Media, another marketing agency, specialising in search engine optimisation and social media.

Founded in 2006, Reload Media turned over $1.1 million in 2009-10 and has clients such as Subway and Price Attack. Jury claims he needed only $500 to get his business started – $400 for ASIC fees and $100 for stationery.

"Everything else was borrowed," he says – adding that his office was a room under his house.

Jury comes from the advantageous position of having set up a marketing company previously, Alfresco Design, which he sold to the John Singleton-owned media group STW in 2006.

AMOUNT SPENT SETTING UP THE COMPANY

	%
$5k or less	19
$5001-$20,000	11
$20,001-$100,000	31
$100,001-$300,000	21
$300,001-$500,000	4
$500,001-$1million	7
$1m-$2m	3
$2m-$3m	0
$3m-$5m	1
Over $5m	2

Source: *BRW Fast Starters*

THE SOURCES OF CAPITAL*

	%
Savings	68
Mortgage house or investment property	15
Credit cards	13
Family/friends	10
Other	8
Private equity	6
Joint venture partners	4
Banks	3
Public raising	2

Source: *BRW Fast Starters*

* Respondents could choose multiple sources

"This was different," he says. "I had paid off my house, I was in a better position financially. My wife was working, I was more relaxed and a I had a lot more contacts."

When setting up his first company, Jury says he lived on a diet of tuna and rice for a year but he followed the fundamentals of setting up a business "lean and mean".

"To kick it off, you need to borrow as many goods as you can," he says. "As soon as you get the first cheque in, invest it back in the business."

Jury says the expansion of Reload Media to 40 staff worldwide has all been funded on profit. The key is knowing when to invest in human capital – following the "three times their salary" rule, Jury says. "If you bring in $120,000 a year, you can put on someone who's worth $40,000," he says. "We use that measure even today as we add more and more staff."

Jury has not raised any further capital and although he says he is always open to venture capital and private investment opportunities, it is more likely that any capital would come from bank funding to invest in "hard" assets, such as property for the business.

Many start-up businesses told *BRW* they were not keen to give away equity in their companies at such an early stage. "I felt we shouldn't ask for other people's money until we'd learnt to be profitable ourselves," Synergy's Yang says.

Some founders expressed disbelief and annoyance that the banks would not offer business loans without securing them against assets such as property. However, either mortgaging the house or drawing on life savings was motivation for success.

The funding route Fairweather took "obviously drew on our personal savings, however it provided me with more ... determination to succeed knowing it was my own savings on the line."

With minimal interest from the banks and a reluctance to turn to private investors in the early stages, many companies use their own capital, in the form of savings, credit cards or mortgages on personal property. These avenues are seen as low risk but can often leave companies under-funded.

"If I had my time again, I would do what I could to get more start-up capital," Fullin says. "Three or four times more than the initial capital of $50,000 would have been better. Without it, growth in the early years was stunted.

"I couldn't employ the right staff, [because] I didn't have the money to pay them," he says. "I couldn't lease the correct office, couldn't buy the right equipment, nor do the right marketing. Our marketing budget was zero, it was just me handing out my business cards."

It took a couple of years for Palladio to turn a profit but now Fullin feels more confident in the future. The company recorded revenue of $5.2 million in 2009-10. He and his wife have just drawn down a further $100,000 from their own mortgage. The proceeds will go towards radio and print campaigns and a refresh of the company's website.

Despite wishing he had taken further capital at the start, Fullin is happy how things have turned out. "It was the right fit for me and my wife, we had full control over the company and no one was telling us what to do. In the back of mind was that we could lose our house but ... when you've got that pressure on you it makes you kick more goals." BRW