How do Entrepreneurs Finance Their Startups?

A potential new business owner asked a great question after reading my last few columns. She said, “I really want to start my own business, but how do most new startups get the financing to start their business?”

The simple answer is that when it comes to financing their startups, most entrepreneurs prefer to bootstrap it their first year. However, there are many considerations and routes taken by these potential owners to get their business off and running. I will share some things that we learned when we asked SCORE clients.

According to a recent SCORE survey of roughly 1,000 small business startups from across the country, a whopping 78% of respondents said they relied on personal funds and income from another job to get their startup off the ground.

Bridget Weston, the Acting CEO of the SCORE Association, summarized the results of a recent survey that served as the foundation for SCORE’s fall 2019 “Megaphone of Mainstreet: Startups” data report. As a mentor, it was not surprising to find that these start up CEOs revealed that one of their top concerns was securing enough cash flow to maintain their business and support their personal needs.

This study revealed how startups prepare for this financial uncertainty in that all-important first year.

Startup owners turn to personal financing to launch their businesses.

One of the most surprising statistics to emerge from the report was just how little debt entrepreneurs are willing to take on when it comes to launching their startups. The vast majority of new small business owners don’t seek financing from bank loans, cash advances on credit cards or even loans from family and
friends. They also didn’t look for alternative methods of financing such as investors, crowdfunding or grants.

When asked where their initial startup capital came from, entrepreneurs overwhelmingly relied on their own resources:

- Personal funds: 66.3%
- Income from another job: 27.6%
- Borrow from friends/family: 11.3%
- Bank loan: 11.2%
- Cash advance from credit cards: 9.0%
- Donations from friends/family: 6.4%
- Investors: 3.4%
- Grants: 2.1%
- Crowdfunding: 1.7%

Despite the prevalence of bootstrapping, however, the report makes clear to point out that startups did not begin their businesses without financial resources. It showed that:

- 42% of entrepreneurs started with less than $5,000 in cash reserves.
- 49% started with more than $10,000.
- 24% started with more than $50,000.
- 78% did not seek outside financing.

The percentage of all startups successful in obtaining financing reported these sources:

- Bank or other financial institution: 8.2%
- Friends / family loan: 4.8%
- SBA loan: 3.1%
- Online lenders: 2.3%
- Angel investors: 1.4%
- Crowdfunding: 0.8%

Only 10% of all entrepreneurs received startup funds of more than $25,000.

Outside funding was used to pay for equipment, not salaries.

Despite their cash flow concerns and their worry about being able to support their own personal needs, less than a quarter (24%) of the entrepreneurs surveyed reported using outside financing to pay their own salaries and only a slightly higher percentage (26%) reported using the funds to hire staff. Equipment purchases topped the list, with inventory purchasing running a distant second.

When asked how they used outside financing in their first year, startup owners primarily added assets:

- Purchasing equipment: 63%
- Purchasing inventory: 48%
- Marketing: 48%
- Leasing and preparing business location: 41%
- Product development: 27%
- Hiring staff: 26%
- Paying my salary/support during startup: 24%
- Other (licenses, operating expenses, etc.): 11%

**What should you do?**

When it comes to financing their startups, the data show that entrepreneurs are largely self-reliant. However, choosing the right source of financing for your small business is a lot more complicated than it used to be, and not everyone can pursue their dreams by bootstrapping.

If you’re ready to launch a business and are looking into ways to finance operations, a SCORE mentor could help you find the solution that’s right for you.
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