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Nonprofit Lenders Lower Startup Funding Risk

By Finance New Mexico

Entrepreneurs traditionally dipped into personal savings or tapped their friends-and-family network to fund a startup, and they used credit cards and home equity lines of credit to buy equipment or make payroll. If the venture stumbled and revenue evaporated, the owner faced years of compounding debt.

Those risks haven't disappeared, but today's business owners have more funding options, including a network of New Mexico nonprofit lenders.

Almost half of startups run by solo entrepreneurs in the U.S. need no outside funding. Some are fueled by the owner's salary from a primary job — a relatively safe way to test a sideline venture's potential to build momentum and become a full-time gig.

Others use crowdfunding, a low-risk source of cash that doesn't require the entrepreneur to assume debt. Platforms such as Kickstarter and Indiegogo allow entrepreneurs to pitch a product or service to casual investors who expect little in return. When Albuquerque-based Aqua Research LLC offered its H2gO personal water purifier on Indiegogo, it raised more than $26,000 from 300-plus backers. Likewise, Santa Fe arts collaborative Meow Wolf raised more than $100,000 through crowdfunding for its House of Eternal Return, offering investors T-shirts and the chance to support an exciting venture.

The risk level rises when entrepreneurs use retirement savings and home equity–backed loans to fund their ventures. Outside investors like seeing an entrepreneur put her own money on the line, but drawing down a retirement account is risky and, with early withdrawal penalties, costly. And using home equity commits collateral that might otherwise help secure a bank loan.

Credit cards — though easy to obtain and interest-free if balances are paid off within 30 days — are even riskier, though the U.S. Small Business Administration reports that almost 10 percent of businesses are willing to take that chance. Credit card interest is higher than a traditional lender would charge on a term loan or line of credit, and if the owner can't afford more than the

minimum payment or misses payments, the ensuing debt and credit blemish can turn off potential traditional lenders.

"High revolving debt balances — like carrying high credit card balances — often reflect poorly on personal credit reports," said Metta Smith, vice president of lending and client services at Accion, a microlender that helps entrepreneurs avoid more costly and risky types of borrowing. "By refinancing to a term loan, you take that revolving debt off their credit report, and that may significantly help boost the individual's credit score."

Smith recalled a loan Accion offered a client to finance an educational brand that aimed to promote healthy eating in elementary schools. The owner, she said, "was paying off approximately $9,000 across three personal credit cards and it was costing him around $2,000 per month. We were able to pay off the cards and provide him with a $10,000 term loan, costing him less than $300 per month."

Accion lends more than money; it also lends various types of support, including business mentors whom Accion has helped. To learn more about Accion, visit https://us.accion.org/.

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