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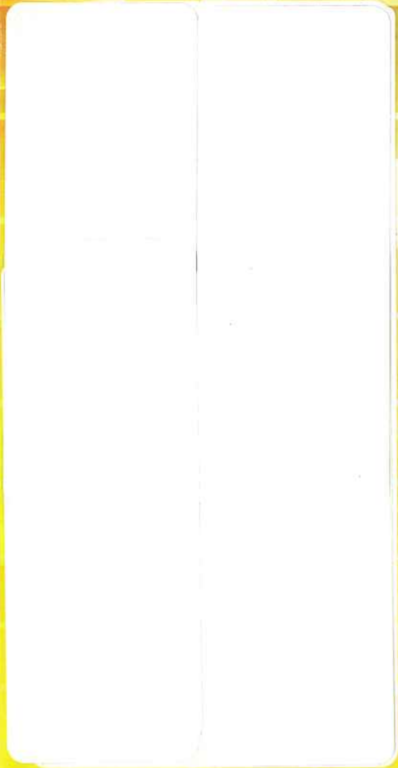

Financing Your Business

Accessing Capital in Challenging Times

By Lance Tullius

IF YOU'VE EVER ATTEMPTED TO RAISE CAPITAL—be it debt, equity, or some other type of financing—you know that it is not an exercise for the faint of heart. It requires ardent thought, time-consuming preparation, access to the "right" people, a total command of your business, and tremendous patience.

Multiply these requirements several-fold and you'll only begin to appreciate the degree of difficulty to which raising capital in today's economy really is. It is said that banks will break your door down to lend to you when you're flush with cash and don't need their money, but steer from you like the plague when you truly have a need for financing. It could be argued that never has this sentiment been more true than in the current economic environment. Despite this, however, banks and equity sources are sitting on huge sums of capital that it is their business to deploy, making it the equivalent of inventory that must be moved. While times remain tight, there are signs that the financing markets are loosening, albeit slowly, and are expected to continue to do so. For business owners of all sizes, that means don't give up; your time to strike could be just around the corner.

Businesses seek financing for all types of reasons, including as simple as funding working capital requirements, to more substantial initiatives such as to support growth and expansion, amongst a host of other reasons. The reason for and type of financing a business is looking for will, in large part, dictate how a business should go about securing that financing. For instance, a business that has relatively few liabilities on its balance sheet—yet is seeking to grow sales and thus its accounts receivable—may look to a simple line of credit to fund this growth. In that case, the business might simply go to a local lender with limited preparation, but armed with their historical and projected financial statements, and secure the necessary financing in short order. On the other hand, a company that is planning to undergo a major transformation, perhaps through an acquisition of another company or major expansion into a new market or service line, will likely have to navigate a comprehensive and exhaustive path to accessing its capital. And even then, there are no guarantees that it will be successful in getting what it needs.

In the latter example, the starting point to a successful fundraising is preparation, preparation, and more preparation. You get the point; you must have a plan. And it must be a credible and thoughtful plan that proactively addresses challenges and obstacles that financing sources will surely attempt to penetrate it with. It must be built from the ground up, meaning that any and all conclusions drawn must be supported

in detail all the way through. The fastest way to lose the attention and interest of your lender or investor is to answer the question of how you're going to meet your plan with a response along the lines of "the market's just there" or some other vague and nonquantifiable response. Assume little, if anything, about those you're presenting your plan to. To that end, explain your business and why it's viable—in painstaking detail—as much to show your audience of your complete understanding of the business as to educate them about the business. From their response, you'll know if they're interested. If they are interested, the presentation will quickly turn into a back-and-forth dialogue where they're truly engaged and you're no longer selling, but rather passionately conversing.

While many entrepreneurs have a poor comprehension of finance, this particular function must absolutely be a part of any plan and discussion with capital sources. And while a business owner won't necessarily be held accountable to have a CFO-like understanding of financial statements, they'd better have a good understanding or make sure they have a controller or CFO who does. Any presentation made with the goal of seeking capital should include *accurate* historical financial statements, which at least on an annual basis, should be prepared by a CPA. These statements should include a balance sheet, income statement, and statement of cash flows. In addition to historical financial statements, a projected financial model must also be a part of a financing presentation. Such a model should include the three types of statements referenced above, and for the nearest two years ought to be modeled on a monthly basis to show the ebb and flow, or lack thereof, of the business. And finally, as far as content goes, any prospective capital source needs to see and understand how they're going to get their money back, and depending on the type of capital, a return on that money. This should include alternative sources of repayment in the event that things don't go as planned.

If preparing to seek financing requires the tireless efforts of a workhorse, finding the *right* source for your financing necessitates the ingenuity and resourcefulness of a foxhound. Funding will rarely, if ever, show up on your doorstep. There are literally thousands of financing sources, offering varied types of financing, that make it the equivalent of searching for a needle in a haystack lest you have some specific direction already mapped out for you. Generally, there are two types of financing; debt and equity. Within these types, there are also various subcategories of financing. Debt represents the most conservative form of financing, whereas equity brings with it the prospects of great returns, yet higher risks. Debt holders require relatively modest returns (interest), are unwilling to take speculative risks and, as such, will usually mandate substantial security before parting with their money. Accordingly, debt financing is most appropriate for companies looking for sums of capital that can be conservatively collateralized or serviced by their assets or cash flow. These characteristics make it particularly difficult for BSCs, whose businesses don't tend to be asset intensive, to secure meaningful debt financing. To that end, the most common form of debt that BSCs have is a standard operating line of credit. This type of financing, often referred to as a working capital line of credit and secured primarily by a company's accounts receivable, is mostly used as a means to fund a company's payroll until its corresponding accounts receivable are collected. Most of us associate debt financiers with banks, but they can also include other types of lending institutions, including asset-based lenders and mezzanine-debt lenders.

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For those companies with more ambitious capital requiring initiatives, debt financing alone will typically not suffice. They generally must turn to more costly equity financing. Equity investors will take on much greater risks then their debt financing counterparts, with the return on their capital essentially coming by way of a future sale or recapitalization of the business they invest in. In exchange for their capital, they most often require a percentage ownership in the company. To owners of small businesses, this may not seem like a lot at the time, but down the road could effectively amount to what becomes very expensive financing. On the other hand, you must remember that if this same business goes belly-up, the equity investor is likely to end up with nothing to show for his investment. In the former instance, you also have to ask yourself how much of an impact the capital from the equity investor had in allowing the business to achieve great success. Depending on the size of your business, equity sources can take the form of private individuals, or firms, private or institutional, that invest and manage larger sums of capital for others. Equity financing is most often required to fund larger objectives like a major expansion into a new market, rampant business growth, and/or acquisitions of other companies.

For small businesses in particular, equity financing sources are far more difficult to find than lending sources. So, unless you already have a good relationship with a potential equity investor, it is sometimes said that "one source is no source." You ought to find a consultant that specializes in helping businesses seek financing. And even though banks are quite easy to find, having or knowing someone who has a relationship with a specific bank is what counts. Regardless of whether you're seeking debt or equity, be it by your own doing, that of a networking acquaintance, or through the use of a consultant, find a way to tap into an existing relationship. In the end, it will save you time and maximize your chances of securing the right type of financing.

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