Business Essentials Library

Money to Grow On

Business partners and investors can finance your company's growth, but capital always comes with a cost. Plus, do you really need that money anyway?

By W. Eric Martin

Business owners are always interested in opportunities to grow and improve their companies, which makes sense since businesses that aren't actively growing typically will lose customers to new competitors and attrition.

But unless you're independently wealthy, expansion will require you to take on business partners or investors willing to loan you money—and these financial contributions have strings attached that can snarl your business growth if you're not careful.

Growing Pains
Wishing for money is fine, but action is the only thing that will get you your desired results. Ralph Alterowitz, president of Potomac, Md.-based Venture Tech Corporation and author of *Financing Your New or Growing Business*, says before the entrepreneur starts looking for outside capital, he needs to answer four key questions:

- What do I need the money for?
- How much do I need?
- How quickly do I need it?
- How much am I willing to pay for it?

Your business might need a capital infusion for any number of legitimate reasons:

- You want to introduce a new product line or type of service.
- You need to upgrade equipment to satisfy existing customers or stay competitive.
- You want to expand your manufacturing capacity or open a new location.
- You want to improve your customer service capabilities.
- You plan to purchase another company to broaden your product line.
- You're developing new advertising programs or marketing campaigns.
- You've created a product or process that deserves to be patented.

New customers with big orders is another possibility. "You might get on QVC [home shopping network], and suddenly sales go crazy and QVC needs 10,000 units," says James E. Burk, co-author of *Financing Your Small Business*, director for the Center for Finance of Growth Strategies Inc., and a partner in the law firm Burk & Reedy LLP, both headquartered in Washington, D.C. "If you can't provide those units, you'll never hear from them again. The same is true with larger box stores; either you make the delivery deadline, or you're out."

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Whatever reason exists for needing funds, you need to put it in writing. "Many business owners who want outside financing haven't put together a business plan with the financial projections that investors look for," Burk says. Writing out a business plan will also help you determine exactly how

much funding you need and by when.

Money for Nothing? Hardly…
The two main ways to raise money for your business are debt financing and equity investing. Debt financing means that you're borrowing money from a bank, a credit union, a rich uncle or some other lender, and that money must be repaid over time with interest. Equity investing takes place when you find someone—whether a partner-to-be, angel investor or venture capitalist—willing to hand over investment funds in exchange for a piece of the pie.

Both debt financing and equity investing have pros and cons, starting with the different expectations of the lenders or investors. "Banks will look to a company's proven, stable cash flow to measure its ability to repay a loan. Risk matters to lenders," says Susan A. Schreter, a venture funding and business valuation expert who writes the "Inside Entrepreneurship" column for the *Seattle Post-Intelligencer*. "In contrast, investors focus on reward to measure their willingness to invest in a business. They look for the potential of fast revenue and profitability growth." No matter who you approach, your business plan should include both current cash flow and projected sales.

Another difference is the cost of the capital. "Equity will always be more expensive than debt to a growing company," Schreter says. With equity investing, you typically give away a percentage of ownership in the company in return for the funds; you might even have to name an investor as your partner. The investor will want to have a say in your business strategy, and venture capitalists will be looking for you to sell out or issue stock within a decade's time so they can make a solid return on their investment.

If you borrow money, you only have to pay back that amount, plus some percentage of interest, so you never cede control of the company to someone else. Still, Burk warns, Younger companies have to be careful with their debt-to-equity ratio. Having too many charges of debt can cause cash flow problems.

"Perhaps one of the most overlooked factors in evaluating different sources of financing is what happens in a worst case scenario," Schreter says. In debt financing, you're typically required to offer collateral on the loan, which means you could lose your house, car or other possessions should your business tank before the loan is repaid. Loans from friends and family can cause strife even in the best circumstances, which means you must treat them like loans from more established lenders and include clauses for every situation so that the relationship doesn't dissolve with the business.

As for equity investing, "while investors don't like to lose money, the financial pain for owners and investors ends on the day a business goes belly up. Owners don't have to repay investors out of personal possessions," Schreter says.

Finding the Funds
You don't want to wait until the last moment to borrow money or ask for investment capital. Either you'll pay more interest because you have no time to negotiate rates, or you'll struggle to find investors willing to meet on such short notice.

When borrowing, you want to apply for a line of credit when you don't need the money, says Alterowitz. Have the interview with the bank president or lending agency, bring them a business plan, and let them get a good feeling about you. This gives you time to shop around, and you won't pay as much from a lender who knows you."

Finding investors can take even longer. "I coach business owners to budget at least nine months to raise money from venture funds and assume that they will spend half of their working time on the effort," Schreter says. During this time, investors will see whether the business can still thrive without your daily oversight. If not, your business needs maintenance work more than new challenges; if it does thrive, however, you could be ready to move into the big time.

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