

Financing Growth

Fit the guidelines to get the money.



by Mary Adams and Mike Oleksak

MONEY IS THE LIFEblood OF BUSINESS. When your business needs an infusion of outside financing, you enter into a process that can be frustrating and confusing if you don't know what you are doing. Many smart business people don't understand why and how things happen on the financing side. This ignorance leads to mistakes and waste. To help you get the financing you need, we share six secrets:

1. Financiers use other people's money. With the possible exception of a true "angel" investor, no one you will encounter in your search for financing actually uses their own money. Never forget this basic truth. All banks, finance companies, investment funds and venture capitalists are merely putting other people's money to work. Financiers get paid for delivering a return on the money investors or depositors have given them.

2. You have to fit "in the box." Financiers raise money and banks authorize lending programs by agreeing to a set of "investment" criteria. To get some of this money, you must understand the criteria (fit inside the box). You may work with a lender or investor who seems to understand you and believe in you but then comes back with a packaged answer—this is "the box" talking. While your investor or lender has some flexibility, they are limited by the investment criteria.

3. It's all about risk vs. reward. The financing marketplace has norms for the pricing needed to cover certain risks. These norms, not your company's unique story, will be the primary driver in setting your pricing. However, you do have some control over how you are evaluated. The key is to understand how your financier defines where you are on the risk spectrum. In some cases, you may provide

them information that mitigates some risks (and lowers your pricing). In other cases, you might look for a partner that "specializes" in your industry or business risk or will accept enhancements such as collateral to lower the risk.

4. Financing is a low-margin business. Financiers hand you millions of dollars and charge a margin of few percent over their cost of money. Out of that few cents on the dollar, they have to cover all their costs as well as the loss of all or most of the money they give to failed businesses. To develop a sustainable business relationship with a financ-



ing partner, you must ensure they can make a fair profit. One area of opportunity is in non-interest fees. Most players count fees in the calculation of their all-in yield on your financing. Ask your financier what return they need and the alternatives for getting there.

5. Three basic questions drive financing decisions. These questions apply for everything from a short-term revolver to long-term equity investment.

• **What are you going to use the money for?** The term of the use should match the term of the money. For example, if you have occasional shortfalls due to large accounts receivable or need to buy inventory to fuel a growth spurt, a revolving bank loan will fit the bill. Likewise, long-term assets should be financed according to their expected life. A computer that can become obsolete in three years would require a faster payback. The riskiest investment is in a

business with little more than an idea. This situation requires an equity investment with no specific expiration.

• **How will you pay it back?** The cash flow history is the first area of examination. Financiers look at EBIT (earnings before interest and taxes) as the best way to understand the cash flow. A lender will want to know how comfortably the cash flow covers interest, principal, and taxes. A consistent cash flow with a positive trend is helpful. Most companies don't have a perfect trend, so having good explanations is important. In an early-stage company, when the company will become self-funding and when it will reach a size for an IPO or merger.

• **If your planned payback fails, what fallback does the financing source have?** Borrowers assure us, "I will pay you back." We believe them. Our institutions believed them. But unexpected, sometimes bad, things happen to companies. So, we need certain fallbacks. This is why bankers often take assets in security of loans. It is also the logic behind guarantees. Even unsecured loans and equity investments have terms that give the financing source increased or new rights if things don't go as expected. The financing guidelines require fallback of some kind—either security or increased rights for the financier when things go wrong.

6. Quality information gets quality results. Your contact will have to make a presentation to a committee to get you a funding commitment. Even if your contacts have sole authority to approve your funding, they will still have to document their decision. Their presentation will explain the purpose, repayment, and fallback. Ask your contact what information they need and then prepare a clean, neat package that makes it easy for your contact to present your company in a good light.

In the financing business, you will greatly increase your chance of success if you understand the perspective and needs of potential financing partners. Your contact is constrained by a set of policies or guidelines. Help them to understand how well you fit those guidelines, and you'll likely get the money you need. **EE**

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ACTION: Finance your growth.