Best Ways to Secure

Capital for Your Business

THE ALTERNATIVE BOARD

Shared Wisdom, Bottom Line Success

Financing Strategies for Business Owners

The past decade has been a transformative one for small business financing. Traditional credit markets have tightened since the Great Recession, while new technology is making it easier than ever to secure alternative sources of capital in the form of non-bank, online lenders. Equity investments from venture capitalists are also on a multi-year rising streak, providing many small businesses with yet another potential way to find funding.

Whether seeking startup capital to get their ideas off the ground or a line of credit to accelerate business growth, small business owners continue to need reliable sources of financing.

The Alternative Board (TAB) wanted to understand what options are available for business owners, and how they are navigating their options. That's why our recent Small Business Pulse Survey concentrated on the strategies, sources and lessons learned raising capital for small businesses.

We surveyed ***325 business*** owners. They are:

Successful

88%

have been in business for at least 8 years

53%

in business for more than 20 years

Profitable

63%

have annual revenue of **$1 million or more**

Small

23

The mean number of employees was 23

39%

have 2-9 employees

42%

have 10-49 employees

Diverse

Respondents came from the U.S., Canada, the UK, New Zealand and Ireland, from a variety of industry sectors.

(The most common were Professional Services, Manufacturing and Construction.)

Along with gathering information about their experiences in our survey, we also asked them to share tips and advice to help other business owners navigate their own funding challenges.

While small business owners have a wider range of options for financing new businesses and expanding existing businesses, what we learned is that sound planning is still a key strategy. It's more important than ever to approach your search for funding with a strategic plan and to be organized in your business finances. This is borne out in both our survey results and the accompanying advice we've gathered from business owners.

What you will learn in this resource:

1. When the best time is to seek funding for your business.
2. How to differentiate between good and bad reasons for taking out a loan.
3. What funding options are available to small businesses.
4. How you can maximize your chances of getting a loan.
5. Which factors you should take into consideration when deciding on a loan.

Run Your Business as Though it's for Sale

Don't only pay attention to your books when you need financing, or during the end-of-the year tax crunch. That's Jim Horan's philosophy. As owner of Tash Sales Company, he always runs his business as though it were for sale.

Visualizing the finances that way forces Horan and his team to focus on keeping clean records and on improving the profitability and value of the company. "It results in a tighter run business," he says. "We have found in good times when the money is flowing, we tend to be less cautious about what we are spending money on. When things get tight, we realize how loose we have been."

Jim Horan
Owner, Tash Sales Co., Inc.
Wyandanch, NY
TAB Member since 2011

Is it Time to Seek Financing?

We discovered that the type of funding our respondents sought varied according to the stage of business they were at. Two thirds of respondents used self-funding to launch their businesses, while 83% have gone on to raise capital since the launch of their businesses.

This suggests that the trend among small business owners is to bootstrap a business in the beginning, then to seek out a loan or equity funding when the business is more established. This may be less a matter of preferences, and more due to the fact that banks and venture capitalists prefer to invest in businesses which already have an established track record.

When seeking financing, it's important to have a strategic plan — something most of our survey respondents seemed to understand. On a scale of 1 to 10, the mean response was 8.2 when we asked business owners how well they felt they had used external capital.

Respondents gave a variety of specific reasons for seeking out funding after the business had been established, which can broadly be classified into two categories: Stability and Growth Acceleration.

Stability

Business owners seeking external funding for reasons of stability were primarily looking to ease tight cash flow and increase working capital. Business loans can help maintain business stability through a dry sales season by providing the capital to make payroll, purchase goods and cover fixed expenses. However, business owners need to be wary of developing a dependency on this type of loan.

A wide range of companies from traditional banks to online lenders offer short-term loans designed to provide working capital to your business. The credit requirements vary, but keep in mind interest rates are often higher with loans that have more lax credit requirements.

Opening a line of credit or a business credit card is a good way to create a safety cushion for your business without necessarily borrowing the cash right away. Ideally, you should set up this type of loan well before you actually need it. That way, it will be available in the lean times — or during an emergency — without you having to scramble to secure financing.

Common Short-Term Loans for Stability:

Working capital loans or cash flow loans: Short-term loans which give you money to cover regular expenses and operational costs such as rent, inventory and payroll.

Business line of credit: Allows you to borrow and repay only the money you need (similar to a credit card). Typically, the borrower only pays for the interest applicable to the amount that has been drawn.

Invoice factoring or accounts receivable loans: Provide cash up front for unpaid invoices; more suitable for B2B businesses who may have a cash-flow shortfall between delivery of a product or service and payment.

Cash Flow and Growth

Periods of high growth are when many small business owners end up seeking funding. That's only natural, says Beth Gloss, Owner of United Materials, LLC.

For many businesses, growth can often come quickly and unexpectedly, she says. "Even if you did plan for the growth, when you are growing significantly, it isn't reasonable to expect your cash-flow level to remain the same. During a major growth cycle your cash will drop. Period."

Beth Gloss
Owner, United Materials, LLC
Denver, CO
TAB Member since 2013

Opening a line of credit or a business credit card is a good way to create a safety cushion for your business without necessarily borrowing the cash right away.

Richard Simmons, Facilitator and Coach for TAB Auckland South, agrees with Beth. He recommends that business owners be pre-emptive when they see a growth situation on the horizon. "Meet with your bank well in advance of the cash crunch, and do a professional organized presentation of what is occurring," he says. "Banks will normally provide you with more credit when things are going well."

Richard Simmons
CEO, TAB Auckland South

Growth Acceleration

Survey respondents who sought external funding in order to grow their businesses invested in things like buying equipment, expanding facilities and purchasing major assets. These types of loans often require better credit than shorter-term working capital loans, though the majority will have better interest rates and more consistent payment structures.

Have a game plan in place before applying for a loan. Ask yourself the hard questions about your plan. Will your investment yield lasting value to the business? Will you make enough income from the loan to be able to comfortably pay it back over time?

A good investment *increases revenue to pay for itself:*

- Hiring a sales director
- Opening up a new location
- Adding on a new service
- Developing a new product

A bad investment *doesn't directly help you repay the loan:*

- Financing ongoing losses
- Acquiring non-essential business assets
- Remodeling office space

Potential lenders are more likely to approve a loan when they can see you have a clear plan for investing the cash. Plus, thinking strategically about how your investment will pay for itself will keep you from getting into bad debt.

Use the investment as a yardstick when considering loan terms, as well. Your loan shouldn't have a longer lifespan than your investment — meaning that if you're purchasing a new piece of machinery which you expect to use for ten years, try to get a loan which has a term of about ten years.

Are We Impulse Borrowers?

As with any business decision, business owners need to think long and hard about financial decisions. John Hart, President of Peak Engineering, cautions business owners not to let themselves get distracted by "good deals" when thinking about expensive financial decisions like expanding through acquisitions.

He likens considering an acquisition to the temptation of buying the items in the "bargain bin" at a store. If a company is suddenly on the market and looks like a great fit, it can seem more appealing than normal. Hart recommends asking this question: "If this company was not 'On sale this month only...' would we still be interested?"

Under normal conditions, is this a good move? Or are you letting the temptation of a "good opportunity" cloud your judgement? "We should ask ourselves the tough questions before we exhaust too many resources in discovery, due diligence and negotiation," says Hart.

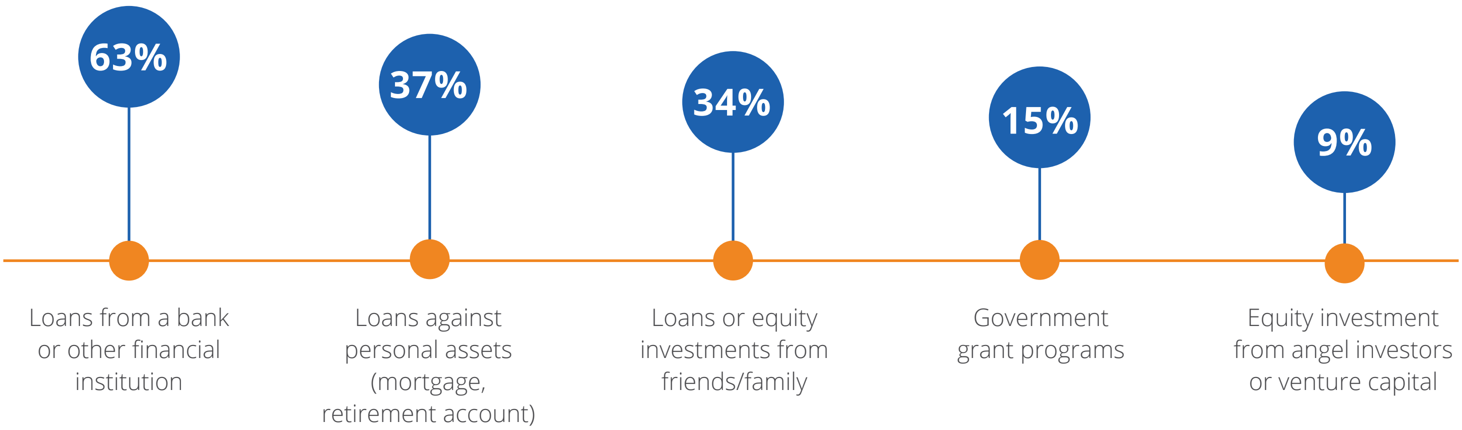
John Hart
President, Peak Engineering, Inc.
Lakewood, CO
TAB Member since 2010

Your loan shouldn't have a longer lifespan than your investment.

Types of Financing

There are three broad categories of financing sources for business owners: self-funding, borrowing and equity/ venture capital.

As we mentioned, many of our survey respondents chose to self-fund their businesses when first starting out. But when they did need to raise capital — whether for startup costs, operating cash flow or expansion investments — their primary sources varied. (Note that some raised capital from multiple sources.)



Self-Funding (Bootstrapping)

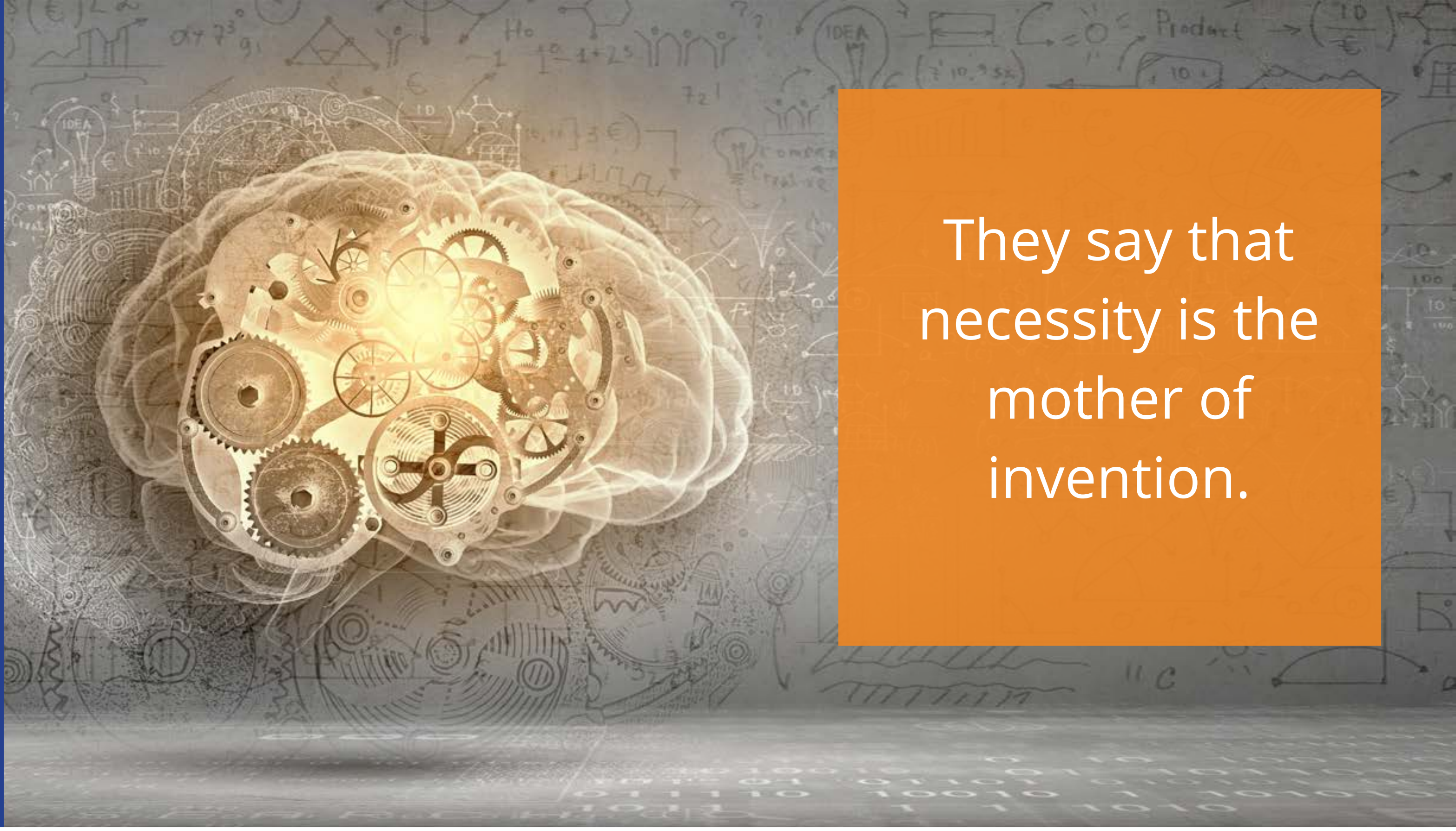
Self-funding is defined as the use of one's own funds: from savings, selling assets or by cashing out a retirement account or other investments. The source of capital could also be the business owner's salary, if he or she is working another full-time job while funding the business venture.

The benefit of self-funding is that the business owner remains in complete creative and strategic control of the business' direction. Additionally, the business isn't burdened with the additional costs associated with debt. The drawback is that business growth will generally be slower and more organic, and you may not be able to take advantage of certain business opportunities if you don't have ready cash on hand.

Rollover as Business Startup (ROBS)

One newer form of self-funding is driven by the retirement trend of the Boomer generation. The 2015 Kaufmann Index found that one quarter of all new entrepreneurs were people aged 55-64. Many of this group are newly retired Baby Boomers who are funding their new ventures with their 401(k) accounts through a process known as Rollover as Business Startup (ROBS).

The advantage of ROBS is that it can provide an equity injection into the business without the higher costs of traditional loans. It can also help provide equity reassurance.



They say that necessity is the mother of invention.

The Power of Creativity

They say that necessity is the mother of invention, and nowhere is that more true than when trying to get a business off the ground without extensive capital. Just ask John Sperry, the founder of customer experience optimization company InMoment. After he lost his job when the tech startup he was working for closed its doors, he went to work on a new business idea — with no income and no startup capital.

“You have to find creative ways to work on the cheap without the need for a lot of cash,” he [told BusinessLoans.com.](#) He and his initial team worked hard to reduce costs, which in the end created a much more innovative product to take to market. “We had to do a lot of outside-the-box thinking, which was very good for us.”

Sperry recommends businesses bootstrap as much as they can initially, to keep their options open without giving up ownership of their company. “I feel like a lot of what makes us a successful and unique company has been the fact that we haven’t had to change our business to accommodate any outside investors,” he said.

John Sperry
Founder and CEO, InMoment
Salt Lake City, UT

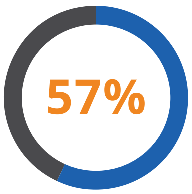
Sperry recommends businesses bootstrap as much as they can initially, to keep their options open without giving up ownership of their company.

Borrowing

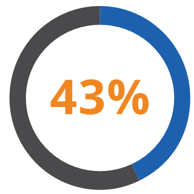
We asked respondents where they would turn if they needed to raise additional capital in the future.

51% said they would turn to a bank or other financial institution.

This is despite a strong perception among respondents that it is **generally harder to get these types of loans** in recent years.



said it was generally harder to raise capital from banks.



said it was generally easier to raise capital from banks.

This in itself isn't a major gap; however, more than three times the number of respondents said it was "much harder" than "much easier" to raise capital.

Despite the popularity of this option, there can be significant barriers to being approved for a loan. Of those respondents who had sought financing but weren't able to secure it, the number one reason was insufficient collateral, followed by the business being considered too risky and the business being too new.

Although traditional banks and other large financial institutions can have stringent requirements about credit scores and collateral, recent years have seen the development of more flexible options. Be aware that options that are more lenient on credit score tend to have higher interest rates.

The most common places to borrow money are banks and other traditional institutions, SBA loans and online lenders.

Traditional Banks

Banks are the largest source of financing for small businesses and, as such, can offer some of the lowest cost loans on the market. However, the application process can take an extensive amount of time, and banks require borrowers to have strong business and personal credit scores.

Levels of service and responsiveness can vary across institutions. Survey respondents found that small community banks do a better job of serving local business owners than the larger institutions (44%, versus 27%).

When going with a traditional bank, it pays to plan ahead. Expect the process of applying for a loan to take one to three months.

New technology is making it easier than ever for small business owners to bypass traditional funding routes through online lenders.

Online Lenders

New technology is making it easier than ever for small business owners to bypass traditional funding routes through online lenders — but it's more critical than ever for business owners to do their research when applying for these kinds of loans.

One major concern is transparency. Online lenders face fewer regulations than traditional banks, and business owners can be hit with hidden fees, misleading APRs and cripplingly high payments. In response, a coalition of lenders and business organizations formed the Responsible Business Lending Coalition to drive responsible lending and drafted a Small Business Borrowers' Bill of Rights.

The benefits of financing through an online lender are faster access to funds and more options for businesses with less-than-stellar credit scores.

Small Business Administration (SBA) Loans

The Small Business Administration is another valuable source of financing. Because they're guaranteed by the federal agency, lenders can offer more flexible terms and low rates — allowing small businesses to grow without taking on too much debt burden. Some business owners have even used SBA loans to refinance their higher-interest debt and save.

Banks are still the most popular place to get an SBA loan, though online lenders specializing in SBA loans have emerged in recent years.

However, the SBA's requirements are stringent, the application process can be lengthy and the loans are restricted to businesses in certain industries. If you're considering an SBA loan, start at sba.gov to view their requirements and checklists.

Take the time to build a relationship with your lender, starting long before you need the loan.

Build a Relationship

Don't just think of applying for financing as though you're conducting a business transaction. Instead, take the time to build a relationship with your lender, starting long before you need the loan. That way, your lender will have a more vested interest in your success, and they can be a valuable business resource.

Kristine Van Cleve, President of Dental Prosthetic Services, recommends that business owners be in regular contact with their lenders. "Help them see you as a person and part of the community — not just a loan application," she says. "Keep the relationship ongoing."

Kristine Van Cleve,
President, Dental Prosthetic Services
Cedar Rapids, IA
TAB Member since 2008

Be Prepared

What would you do if your banker or accountant asked to see your company's financial status right now? For most companies, the answer would be to spend several hours frantically hunting down documents and updating accounting software.

Not Bob Zarlengo's firm, Zarlengo Raub. "One of the best things that ever happened to our company was our banker demanding that we present our financial status whenever they asked for it," he says. "They rarely have, but we have instilled the discipline to be prepared for the 'on the spot' inspection. It has been an excellent practice, and I advise our clients to adopt it."

Bob Zarlengo
Partner, Zarlengo Raub LLP
Wheat Ridge, CO
TAB Member since 2011

5 C's of Credit

When preparing to work with lenders — both traditional and non-traditional — keep in mind the 5 C's of Credit.

Credit Score

The borrower's track record for repaying debts. Many lenders will look at both your personal and business credit score.

Capacity

Measures the borrower's ability to repay the loan by comparing income against recurring debts and assessing the borrower's debt-to-income ratio.

Capital

The amount of capital a borrower is able to put up front against the investment.

Collateral

The top three business assets our survey respondents used as collateral are: business property, accounts receivable and inventory. Many also used personal assets (savings, property) as collateral.

Conditions

Interest rate, amount of principal, terms and purpose of the loan all influence the lender's desire to finance the buyer.

Venture Capital/Equity

Securing equity investment from venture capitalists is a coveted form of financing — particularly for new startups and business owners who are looking to grow a business in order to sell it.

Equity financing involves raising capital by selling shares in the business. This can run the gamut from a few shares sold to friends and family to well-publicized initial public offerings (IPOs) that raise billions. This isn't only an option for public companies — private companies can also sell equity shares.

While equity investment can help spur rapid growth, it's not the best option for all businesses. By trading ownership shares in exchange for cash, owners give up complete control of their businesses. We asked respondents who had secured equity investment to tell us about their experiences. Although most felt they gave up just the right amount of ownership, one in three (37%) felt they gave up too much ownership. Only 2% felt they gave up too little.

Seeking equity investment also requires a firm vision and strong negotiation skills. We asked respondents whether they felt they or the investor had the upper hand in the negotiation and found the results were well split. 53% believed the investor had the upper hand, while 47% believed the business owner had the upper hand.

What About Crowdfunding?

Crowdfunding platforms like Kickstarter, Indiegogo and GoFundMe are becoming an increasingly popular source of funding for small businesses. Are they right for you?

Andy Jacobs, VP of Strategy for search marketing firm Didit, recommends that clients explore crowdfunding as an option. As he explains it: "The crowdfunding model has three parts: 1) the project initiator who proposes the idea and/or project to be funded; 2) individuals or groups who support the idea; and 3) a moderating organization (the "platform") that brings the parties together to launch the idea."

Like any funding method, crowdfunding has its peculiarities.

1. It can be extremely difficult to attract individual investors in the numbers required to raise enough funds. In order to generate buzz, funding seekers must commit to an extensive marketing and PR push.

2. Although the money seems "free," it comes with strings attached. Backers generally expect rewards for their contribution, which normally includes branded merchandise, perks, products, benefit events or special recognition. Keeping backers updated on progress and fulfilling rewards after the project funds can be time consuming.

3. Crowdfunding works best for discrete expansions, products or projects. Backers want to feel like they're funding something specific, rather than contributing to ongoing operational costs.

Keep in mind that the people who invest in your crowdfunding campaign aren't just purchasing a product — they're buying into the philosophy of your company. This makes crowdfunding a powerful tool for mission-based companies, or those that serve a strong need within a passionate niche community.

Andy Jacobs
VP of Strategy, Didit
Mineola, NY
TAB Member since 2013

5 Simple Tips to Keep Your Business Finances in Order

Whether you're getting your books in order to apply for a loan or simply want to have a better grasp on your books, David Wechsler, Vice President of TAB Denver West, has some advice:

Keep things separate. Handle your business and personal accounts (bank and credit card) as independently as possible. If you think personal expenses may qualify as a business deduction, mark them accordingly.

Call in a pro. Hire a bookkeeper or accountant that has some familiarity with your industry, then keep clean, up-to-date records to save on billable hours. Remember, you are not paying someone north of $75 an hour to do data entry — you are paying them for guidance, compliance and peace of mind.

Pencil in the time. Set aside 30 minutes every week to organize your finances. Something will always feel more pressing, but when you find the time every week, you'll feel your stress levels — now and at year-end — fall fast.

Consider your people. Don't forget to properly track what is likely your biggest expense: labor. Whether you're paying a full staff or you're the only one on the payroll, tracking your spending on labor, perks and benefits will give you big insights into your spending.

Don't forget to get paid. You would be shocked at how many business owners don't properly track invoices and customer payments. If you're not keeping proper Accounts Receivable records, you could be collecting payments late or missing some altogether.

David Wechsler
Vice President, TAB Denver West
TAB Facilitator and Coach

Matching Your Financing Method to Your Strategic Plan

When you're considering where to seek funding, it's critical to be thorough in your research and understand how your financing method fits with the overall plan for your business.

- Do you want to retain more or less control of your business?
- Do you want to grow rapidly or organically?
- Are you risk tolerant, or do you need stability?
- How quickly do you need the funds?
- Do you have an existing track record with lenders, or do you need to develop new lending relationships?

Before making a decision, ask yourself these questions to get a more thorough understanding of your business.

Our respondents overwhelmingly would advise other business owners only to borrow if they have no other option — but to borrow aggressively if it will accelerate growth. The most important lessons they shared were to: borrow at the right time (34%), from the right source (34%), at the right amount (19%) and have the right advisor at your side (13%).

Taking on debt in exchange for business growth can be a smart investment, but as with any business decision, you shouldn't rush in without a strong plan.

Is TAB for You?

The Alternative Board® (TAB) helps forward-thinking business owners grow their businesses, increase profitability and improve their lives by leveraging local business advisory boards, private business coaching and proprietary strategic services.

Becoming a member of The Alternative Board gives you access to resources and expert firsthand advice from other business owners to help you create a plan, avoid financing pitfalls and navigate your options. Find a TAB Board near you and begin growing your business today.

Was Financing Strategies helpful to you? Help someone else out by forwarding to a colleague.