ANNEAL BUSINESS COACHING

Raising Cash for Growth

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RAISING CASH FOR GROWTH

All of us in business are concerned with cash.

We are under constant pressure to balance a limited supply of cash with the seemingly unlimited demand from cash-consuming sinkholes such as operating expenses, accounts receivable and inventory - and that's just normal operations.

Things get really hard if we're growing. Growth requires more and more cash to finance higher operating expenses, more receivables, more inventory, larger facilities, more machinery, more equipment and so on.

Growth almost always means we need to raise cash, and the most common way to do that is by borrowing. Many of us struggle with that because conventional wisdom tells us that debt is bad. It's in our psyches.

Debt IS bad - if we use a credit card to buy a round of drinks for our buddies, or a bank loan to finance a Cadillac Escalade for the tax write-off. But, used properly, debt is also one of the most powerful tools in business and has tremendous advantages over the alternatives.

ALTERNATIVES?

There are two alternatives to debt for increasing cash in our businesses. One is by self-funding a cash reserve through savings, and the other is by selling equity (ownership) in our companies.

SAVINGS

The least risky way to finance our cash needs is to build a cash reserve from our business operations. The advantages of a self-funded reserve are that:

- It's our money, so we don't have to pay it back, even if we go broke,
- There is no interest expense,
- There are no monthly payments adding to our cash demand, and
- We still own 100% of the business.

Those are compelling advantages, but self-funding has some drawbacks, too:

- It's hard to do quickly. Most of us are already strapped for cash and accumulating a reserve takes time, so long that we risk missing substantial opportunities for growth.
- There is no financial leverage (defined below) when we operate entirely with our own money.

SELLING EQUITY

Selling equity means give up part ownership company to someone in exchange for cash. The advantages of selling equity are that:

- Again, we don't have to pay it back. Because it is not a loan, there is no obligation to repay an equity investment. Investors take on the risk of ownership, just like the owner. If the company goes broke, nobody gets their investment back.
- Because it is not a loan, there is no interest and there are no monthly payments.
- We may be able to raise more money through an equity sale than we could through a bank.
- We may be able to raise more cash, more quickly, than we can through savings.

Those also are attractive advantages, but they are offset by three unattractive considerations:

- **Valuation**
  ○ In order to know how much of the company to give up in exchange for a certain amount of cash, we have to know the value of the company as a whole. Valuing small companies is very subjective, and it is, more often than not, difficult to reach agreement with prospective investors.

- **Partners**
  ○ An equity investment means that we bring on co-owners as "partners". The moment we bring on partners, we have other people's interests to consider in every decision we make. Perfect partners can be wonderful additions because they can bring good judgment, perspective, ideas and collaboration to the business, in addition to cash. Most partners, however, are not perfect.

- **Dilution**

  ○ When we sell part of a business, our share is reduced, or "diluted." As co-owners, equity investors are entitled to their share of profits for the life of the business and to their share of the proceeds if the company sells. Dilution means that selling equity in a successful business is likely to be, by far, the most expensive form of financing.

DEBT

Debt, of course, means we borrow the cash. There are three advantages to borrowing:

- **Financial Leverage**

  ○ Leverage is the most attractive reason to borrow money. When we put borrowed money to work effectively, meaning that we use it to make more money instead of buying drinks or cadillacs, we can see a remarkable boost in the return on our investment.

- ○ To show how it works, assume we invest $1.00 in the business and make $.10 profit. That's a 10% return on our dollar. Now assume we borrow additional $9.00 and use the $10.00 to make $1.00. That's a 10% return on $10.00, but it is a 100% return on our original $1.00 investment. Yes, our return would be something less than %100 because of interest on the borrowed money, but you get the idea.

- **Not complicated**

  ○ Borrowing is well understood, and the process and documentation are settled and clear. Borrowing is likely to be far simpler than raising money through equity sales, and far faster than saving..

- We retain the ownership of our companies and don't have to take on partner

- Those are good reasons to borrow money, but there are also reasons not to borrow money:

- We have to pay it back, and, because of personal guarantees, most of us will have to pay it back even if we go broke.
- Borrowing increases our expenses because we have to pay interest.
- Borrowing places demand on our cash flow because we have to make regular payments.
- We have to qualify for loans, which we may not be able to do, and we likely will have to live with restrictions placed on us by lenders.

WHICH WAY IS BEST?

There are three ways to raise cash for growth: savings, equity and debt.

It is not possible in this article to say that one method is the best for every company. Some companies use hybrid combinations of all three to meet their cash needs.

However, for companies that have effective growth opportunities and need cash to fund them, it is hard to beat debt as a means to raise it. Debt is faster than savings, better understood and cheaper than equity, and offers the huge potential of financial leverage.

HOW ABOUT YOU?

Do you need to raise cash for growth? Do you have opportunities for growth? Do you have the cash to fund them? Which method looks most attractive to you?

If you have any further questions, please don't hesitate to mail me at Martin@annealbc.com or visit www.annealbc.com

Martin Holland

Martin Holland is the son of a successful entrepreneur. He grew up hearing about margins and markets, R&D and sales, risk and return on investment. He learned to love the language and rigors of business and grew to believe that business is both the most human of all endeavors and the highest calling. After selling a company in 2011, Martin became a coach in order to help other owners build profitable businesses that do not require their day-to-day involvement.

A native of Norman, Martin earned a B.A. degree from Hastings College in Hastings, Nebraska and a Masters in Business Administration degree from the University of Oklahoma. Over the past 7 years he has written business plans that have raised over $52.4 million in bank and investor financing. He has helped 157 (and counting) business owners reduce stress and increase performance through clarity of purpose, better marriages, more money, and more free time away from the business.