Positioning Your Company for Debt Financing

-From a speech given at the SmartStart 2000 Albany Law School Science & Technology Center. The following report is the first in a series of what we at PBCC www.pbcc.com feel will help you look into alternant sources of debt for your business.

There was a time in the old days when going to the bank was the only way to get outside capital for your business. These days with the explosion of raising equity investment, many of the guidelines for running a company have been revolutionized. Unfortunately this new phenomenon is only true for companies with super "star power", because these companies have potential to create sky-rocket return earnings.

For everyone else, sticking to fundamentals is where it's at. Building your company incrementally, following a pre-prepared business plan, watching expenses, and increasing sales. When your company moves beyond its launch, it begins to operate much like a bank. On the financial side you will be making credit decisions
involving your customers. Some will have to pay C.O.D., some you will extend net 30 day terms. In this sense you are now becoming a banker for your customers.

Without getting into how inexpensive debt financing ultimately is compared to equity (try 20% annualized interest versus 20% ownership lock stock and barrel), in certain situations the time honored tradition of borrowing money can be the best solution for increasing growth or starting a company.

By knowing what commercial finance companies look for, you will become a much more attractive prospect.

1. **Concentration** - This means putting all your eggs in one basket. Avoid going out and making a large sale to a customer and then not continuing your sales effort to find more customers. The risk of a problem developing with your main customer, or for whatever reason they are no longer buying from you can obviously be detrimental to your success. Finance companies look for incoming revenue to be spread evenly over a number of customers.

2. **Creditworthiness** - Who are you lending your hard earned assets to? What kind of due diligence do you perform on new customers? The challenge here is whether to accept a lucrative sale with a company that could never get credit from any type of finance company. You are essentially telling yourself that you know better than the banker about loaning money. Finance companies will respect a business owner that has a thorough credit checking process and a number of stable credit worthy customers.

3. **Book keeping** - While some businesses send out all their accounting to outside agencies, it is helpful to have a qualified book keeper on staff. When it comes time to seek financing, being able to produce an instant fiscal snapshot of your company will show the sophistication of your operation. Finance companies appreciate businesses that keep a close eye on their books.

4. **Taxes** - Pay them. Using the Internal Revenue Service as your funder becomes expensive. Whenever you work with a finance company, you will be pledging assets as collateral, thus the nature of debt financing. When you fail to make tax payments, the government steps in and places a lien against those same assets essentially stepping into first position. This leaves the finance company with money outstanding to your business and no collateral to back it up. This places your entire relationship in default. When going to closing on financing expect to sign a form that allows the finance company to receive duplicate correspondence from the IRS. This is standard procedure to track tax problems. Owing taxes does not mean you cannot get financing. It is entirely possible to receive a subordinated debt agreement from the IRS which allows the finance company to work with you unencumbered.

5. **Bankruptcy** - If you have ever entered into a bankruptcy proceeding whether personal or business, own up to it right away. It will come out, and being up front about the circumstances will enhance the necessity to overlook the past difficulties.

6. **Applications** - Finance companies ask for a variety of information when performing their due diligence. Do not be alarmed, they are not trying to steal your secrets. They need to feel comfortable with you and your company. Each company has its own threshold for fact checking. Invariably the finance companies that do the most thorough job are the most reliable and safest to do business with. Finance companies like working with a business that takes the time to put a loan package together in advance of asking for financing. Typically you can start with; Interim Balance & Income Statement, Interim Profit & Loss Statement, Last Year End Statements, Accounts Payables Aging Report, Accounts Receivables Aging Report, and of course Tax Returns.

7. **Contracts** - Be prepared for onerous language. Finance companies cannot sugar coat the reality that if something goes wrong they need to exercise their rights. They have to go into the relationship always thinking that the absolute worst case scenario will unfold. Once a finance company finds itself being defrauded, stolen from or payments not made without explanation, it's too late to insert stronger language for protection. By and large the language is standardized and walking from a deal to start shopping for less demanding legalisms won't produce much. Remember this, a contract is just paper in a file cabinet until you default on your agreement. Stay within what you agreed upon and all the tough language won't matter. Even if you start having financial difficulties, get in touch with your finance company immediately. You can greatly reduce the chance of default by showing that you are pro-active with your situation.

8. **Using the money for the right reasons** - This sounds obvious but in certain cases it can be highly relevant. You hear a lot about going to the right Venture Capital Firm that would handle your type of investment. In some ways that holds true for debt finance companies. They tend to work within industries that they feel comfortable. Additionally the type of financing company will depend on your plans for the money. If you are trying to set up a new business infrastructure, then a working capital line of credit is not your best option. You will probably do better with a term style loan that will allow you to amortize the expense over a period of years.

9. **Management Integrity** - Also like equity investment, get a good team together and hold onto them. Finance companies raise red flags when a long time Financial Officer who has been the contact person at the company since the inception of the relationship all of a sudden leaves without explanation. Again, always fearing the worst, the finance company could unjustly feel that something untoward was afoot and begin to scrutinize your account more closely. Even though finance companies are not part owners of your business, they are partners in your success just like your good customers. Keep them abreast of breaking news.

10. **Be Professional** - Answer calls and messages expeditiously, be prepared with information, show up on time. When its crunch time and you need an extra fifty thousand dollars for a week to get a better deal from a vendor, you would be surprised how much mileage you can get by being a courteous and thoughtful customer to your finance company.

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For help with your business financing please call us at PBCC, (**800) 916-3280**.