

# Taking on Debt to Grow Your Business

BY SUSAN SCHRETER | February 20, 2012

Stretching a company's working capital through various forms of debt can be the source of just enough extra cash to fund revenue-generating marketing programs or help companies manage when customers don't **pay bills** on time.

The trick to securing debt is first exploring your funding options long before you can't make payroll. Your job is to learn what type of loan best matches your operations and customer activity. Here are a few choices to research:

**SBA-backed loans.** The Small Business Administration (SBA) operates several loan programs for startup and advanced-stage businesses. The first thing to know is that you don't usually apply directly to the SBA for a loan, but to a local bank that participates in the SBA loan program. Some of these loans provide long-term financing for ambitious **real estate** or manufacturing expansion programs, while others help business owners buy franchise outlets or start new businesses.

The SBA requires its partner lenders to adhere to strict underwriting guidelines, so it's not true that SBA-backed loans are easy money. The real advantage of the program benefits partner lenders the most. In addition to bringing in new business, lenders also have the added comfort of being able to turn to the federal government if the borrower doesn't repay the loan in full.

Most local SBA websites list partner lenders, which can include big banks and regional community banks. It's entirely possible to get a "no" from one partner SBA lender and an enthusiastic "yes" from another. Even though SBA administrators are not supposed to recommend one partner bank over another, I find that, when asked in person, they gently steer businesses toward lenders who are most active in a community. Check out [www.sba.gov](http://www.sba.gov) for helpful descriptions of SBA-backed loan programs.

**Asset-based lenders (ABLs).** The range of ABLs -- **financial service** companies that offer asset-backed lending -- is much broader than most business owners realize. And that's good news for business owners who may be discouraged by big-bank lending decisions. Asset-based lenders typically advance funds against a company's accounts receivable, inventory or equipment.

Of course, some lenders are more aggressive than others and will offer lines of credit to younger companies or companies that have recently received a boost of equity from investors. The amount of funds that are advanced under ABLs is dependent on an agreed percentage of the value of the secured assets -- typically 70 percent to 80 percent of eligible receivables and 50 percent of finished inventory.

Notice the phrase "eligible receivables." Commercial lenders cherry-pick your customers, focusing on those that preferably pay in less than 60 days and have strong **credit ratings**. Sales to individuals or small companies may not be considered as "eligible" for loan advances. Interest rates vary according to the size of the line and financial position of the borrower.

Sometimes banks tack on additional "audit" or due diligence fees that increase the overall costs of borrowing through an ABL. Larger banks tend to ask for personal guarantees of company founders and require companies to transfer all other banking relationships over to the bank, too.

**Factors.** Factors are a close cousin to asset-based lenders in terms of providing extra working capital in exchange for a secured interest in a company's accounts receivable. With accounts receivable financing, the stability of a company's customer base is just as important as the creditworthiness of the borrower. It makes sense, too. Factors usually purchase eligible receivables directly from business owners and arrange to have customers submit payments directly to the factor through a "lockbox."

Today, factors provide financing in a broad range of industries, not just the garment trade, where they predominated in the U.S. up to World War II. Theirs is usually the first kind of funding companies can receive after emerging from a Chapter 11 bankruptcy filing. But don't be fooled by the way most factors quote their interest rates. A 1 percent per month **interest rate** is much more expensive than 1 percent per year.

**Revenue-based financing.** Revenue-based loans, or RBLs, are a relatively new kind of loan, well suited to growing companies that don't have a lot of hard assets to lend against. Typically, companies receive an advance of approximately 10 percent of their prior-year revenues. Lenders are paid back each month based on the company's monthly revenue results. So if revenues are growing, then payment to the RBL lender increases; if revenues are declining, payment is reduced.

Internet, film production and technology companies that receive monthly royalties from licensing deals are good candidates for RBLs. However, RBL lenders rarely work with companies with gross profit margins that fall below 50 percent, which is a high bar for young non-technology companies to achieve.

The cost of an RBL is not usually quoted in interest rate terms, though the effective cost of the capital arrangement typically exceeds 20 percent. Expect all revenue-based lenders to ask for some sort of "equity kicker" in your business in the form of a warrant or common stock.

**Microloans.** Microfinance companies, which now operate in all 50 states, offer small loans -- at rates that are usually below those of small-business credit cards -- mostly to first-time business owners, and even to entrepreneurs with a low personal credit score. Loans can range from \$500 all the way up to \$35,000. The average first microloan is approximately \$2,000.

Microloans can be a great solution for many service-oriented startup entrepreneurs who need to buy office, computer, culinary, film production or other supplies to start a viable business. What I like best about the microfinance community is its eagerness to serve business owners in a friendly way. Many microfinance offices also provide helpful training programs on accounting, marketing and sales generation.

Here's a final tip for networking to sources of debt in your community. In addition to asking other business owners in your social network for referrals, talk to your local accountant -- business accountants see the paper trail of lending relationships in their client files.