

Using Debt to Grow the Business

09/10/07

Q. Should I get a bank loan to help me grow the business? My company is small, with a few hundred thousand dollars per year in revenue. I'm planning to use the money for a marketing campaign – to do search engine optimization and to buy ad placement on the Internet. How do I go about getting a loan and how much should I try to get?

A. When considering taking on debt, I urge caution. Debt is expensive, tends to last longer than planned, masks other problems and can get in the way of future growth opportunities if not managed properly. You need to be very sure that debt is your only option, which it often is not.

Keep in mind that you will have to pay off the debt, plus interest, from profits you make. And when you make a profit, you have to pay taxes. That means you may end up paying one-and-a-half times the amount you borrowed, or more, depending on how long you hang onto the loan.

What are acceptable uses of debt? Laying out cash to fill orders, before getting paid by your clients, may be one use. In such a case, you have to be certain that once the money comes in it goes to paying off the debt. Don't let yourself get lulled into thinking you can just keep rolling the debt forward and pay it off later.

What about using debt to fund a marketing effort? Using debt to pay for marketing is like gambling. No matter how certain you may be that the effort will pay off, there are no guarantees, except that you'll have to pay off the debt, no matter what.

SELF-FUNDING METHODS

What are alternatives to using debt to grow the business? Reserve funds, owner's personal investments, bringing in outsiders to invest and selling shares to partners are all alternatives. These are all ways to grow, without burdening the company with debt and interest payments.

Build up reserve funds you can use to invest in the growth of the business. Discipline yourself to put away a little bit of money each month into a savings account you don't touch. You can use that account later on to fund things like cash shortfalls and marketing programs. This may slow down your growth rate initially, but will keep you and your business safer in the long run.

Putting your own money into the business is an option, if you have the assets to do so. Some business owners use home equity loans, where the growth in debt is counterbalanced by generally increasing real estate values. Limit borrowing to something you can reasonably

pay. Don't overextend the house. And be careful of escalating interest rates in today's uncertain market. Whatever you do, don't put your home in jeopardy at the same time you're risking money on a less-than-certain venture for the business.

OTHER PEOPLE'S MONEY

Sometimes outside investors may see merit in what you're doing, and offer to put up money for a piece of the action. You may be able to establish a contract where they are bought out within a defined period of time, assuming things go according to plan. Or, you may offer them stock in the company in exchange for their pledges of funds. In either case, you're not burdening the company with interest payments, but rather are sharing profits once things grow, which makes the money less expensive to use.

Sometimes employees may wish to invest in the company. This can be a bit trickier, as you now have to deal with performance reviews in two directions – how the employee is doing in his or her job, and how you're doing at growing and managing the company. On the other hand, employees who are invested in the company are often highly committed to making sure things work out as planned.

STILL BANKING ON A LOAN?



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What if you still think you need to borrow? The bank will want to know how long you need the money, how you plan to pay it back and that they are going to be your number-one priority if things get tight. They'll also want to know what assets they can attach if things go really wrong.

Be ready for the bank by creating a written plan. Describe your assets, your plan for using the money and two to three ways you can pay the bank back, including personal guarantee, depending on whether things go well, or poorly. Show the bank you're expecting to be conservative and responsible with their money.

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