Debt or Equity

Which is the Best Way to Raise Capital for Your Business?

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My first job out of college was with a *Fortune* 100 company that measured success by market share and revenue. When my team saw opportunities to strengthen our market position, we simply put together a budget and submitted it for funding. Senior management either approved the project or turned it down. Money was a figure on a spreadsheet and we had a seemingly endless supply.

I look back at this experience nostalgically as one might reflect on their childhood. Fun days, but boy was I naive. If you don't have the balance sheet of a *Fortune* 100 company, how do you raise money to support growth, develop new products or pursue opportunities? Company owners generally have just three sources for capital: retained earnings, debt or equity.

Retained Earnings (your company's profits)

The cheapest source of capital is always your company's retained earnings. Run your company profitably and each month the balance of your business bank account grows. Sometimes, however, the best long-term decision is to invest more money than your company can earn and save. For this, you will need debt or equity.

Debt (a loan from friends, family or the bank)

Debt is generally less expensive than equity but can be difficult to obtain and often comes with constraints on the business.

Owners who think they may want to pursue debt in the future are well advised to work with a knowledgeable accountant to make sure all their financial books are in order. Build relationships with banks well before you need money and periodically keep them apprised of your company's progress. Nothing builds confidence with a banker like seeing a business meet its goals quarter after quarter and year after year—particularly when that business is not yet asking for a loan.

Perhaps the most daunting part of incurring business debt from a bank is the personal guarantee. If the business fails, the company owner could lose some or all of their personal assets. Banks always say that the personal guarantee is non-negotiable; however, the rigidity of this requirement changes over time. In other words, sometimes it is more non-negotiable than others. If a personal guarantee is a deal breaker for you, consider hiring a professional debt broker. Unfortunately, finding a good debt broker can be more difficult than finding a bank to lend you money.

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Equity (selling a partial ownership stake in your company)

Equity is typically more expensive than debt, but it comes with greater flexibility. One of the most compelling features of equity is the access to advice and support that comes from a good investor. Unfortunately, the opposite is also true—a bad investor can make your life miserable. Like a marriage, you are entering into a relationship and it is worth spending time to find the right partner. Networking with other entrepreneurs and business owners is one of the best ways to find good investors.

Other resources are investor groups such as the Park City Angels or the Salt Lake City Angels. Venture investors with a focus on Utah companies include Kickstart Seed Fund (early stage) and Mercato Partners (growth capital for expansion stage companies) as well as several others.

If at all possible, you want to be introduced to the investors you would like to approach. While often overlooked, one effective way to get an introduction is simply to see what other companies the firm has invested in and meet with the founders of those companies (investment firms typically list their past and existing investments on their website). Entrepreneurs love meeting with other entrepreneurs and will often agree to help with an introduction. With LinkedIn and other tools, finding someone you know in common with the desired investor is easier than ever.

Take the time to arrange a quality introduction, as it is your first impression and is sometimes a test. The test relates to this question: If you can't get a quality introduction, how will you get in front of customers, suppliers, etc.? That said, if you aren't properly introduced, don't hesitate to pick up the phone and introduce yourself.

Run your business well and maybe one day you will build the next *Fortune* 100 company. If you do, one last piece of advice: Don't hire recent college graduates who naively think the essence of raising money is submitting pretty spreadsheets (like I did 25 years ago ...). UB