# Time to Raise Some Money?

## When seeking financing, improve your chances by anticipating the questions you will be asked

by Michael Oleksak and Mary Adams

Raising financing from outside sources can be an attractive way to fuel growth in your consulting company. But it can also be an overwhelming undertaking if you do not have experience with financing. The task is more manageable, however, if you understand the process and have the right answers to the questions that financing sources will inevitably ask you. Here are a few good questions to consider (and answers too!):

### First question: Why do you want the money?

This is the most basic and critical question.

If you are starting a practice, you are probably not going to get much interest in outside financing sources (beyond friends and family). If you need liquidity at this stage, you will probably have to use personal lines of credit.

As you grow, you will have more alternatives. Growth and liquidity are acceptable uses for outside financing of established companies.

If you have had a successful practice for many years and want to start cashing out, selling a share of your practice to outside partners is often possible.

### What kind of financing do you seek?

There are two basic categories:

1. Debt, such as a loan or line of credit from a bank that carries interest. Debt is the most common outside source of financing for a small service business. The good thing about debt is that you do not have to give away any equity. Although, remember that at some point, the loan principal will have to be repaid in full.

2. Equity, where the money you receive will be recognized by some share (or maybe all) of the company's equity. Equity investors will seek a return in the form of dividends or through a liquidity event, that is, an eventual sale of their stock or the whole company. This type of financing is usually available only to companies with strong prospects of dramatic growth or a very unique product approach.

There are also hybrids, debt instruments that get a small equity or equity-like share to compensate for a loan that is somewhat more risky than a traditional bank loan. These are called mezzanine loans or sub-debt. Sub-debt lenders lend to companies that have good prospects, but do not look for "home run" returns that equity investors seek.

### Are you a sole practitioner or small firm?

If the answer in your case is yes, you may be a candidate for some type of short-term line of credit. You may have to provide a personal guarantee or security in some form, such as a second mortgage. Having said that, we know a one-person firm that obtained an unsecured $15,000 line of credit after being in business for two years. He uses the line to flatten out the ups and downs of his revenues and expenses. He did not have to put up security because his wife has a teaching job representing steady income.

## Is your firm medium-sized to large?

If yes, lenders may be willing to offer a line of credit or loan secured by a pledge of the accounts receivable as well as other tangible assets in the firm. This advance on accounts receivable may be enough of a fallback for lenders to forego a personal guarantee or outside collateral to secure the loan. On the other hand, lenders ask three questions: What will you use the money for (use of proceeds)? How will you repay it (repayment source)? And if that falls short, how will you repay it (fallback)? So there may be a reason for additional support, especially if the cash flow of the business has been uneven. This kind of loan works best with a company where there is a clear deliverable so the receivables clearly represent completed work. In this type of structure, banks do not like to lend on service fees or percentage of completion revenues.

An equity investor would look at the revenue stream and calculate whether the profits of the firm are adequate to generate a good return on the equity investment in the firm.

## Are you a service business or a product business?

Some companies in the actuarial world have developed software (CDMS) and/or online products (Pivot) to help their clients in their engagements. Lenders or investors may see more value in "products" like these than in service-only businesses. A software business is more likely to attract equity, especially if there exists potential for explosive growth.

## Do you have a business plan or a good description of your business to provide to the lenders or investors?

Correct answer: Yes. The plan does not need to be long, but should explain your business, its history, who your clients are, what makes you different from other consultants, your growth plans, and how you will repay your obligations. This plan should be put in a neat package with all the information that the financing source has requested—the easier you make it for the source to understand your company, the better your chances of success.

"No" is a common but incorrect answer. Without a business plan, you lose the chance to share your vision of your business. Others will have to make assumptions about your business and the lack of transparency will reduce the perceived value of the business.

A few years ago, one of our clients, a 30-person technology analysis and consulting firm, was trying to raise subordinated debt. Their business was hard to understand and seemed riskier than it really was. But after presenting a clear business plan, they quickly obtained commitments for $2,000,000 in financing. The business plan also helped them sell the business two years later to a well-known national IT consulting firm.

Prepare a good business plan and you retain control of the process.

## Can you present a financial history as well as a reasonable look forward for your business?

Correct answer: Yes. A lender or investor will want to see audited (best) or reviewed (good) financial statements. Tax returns may be adequate for smaller loans where collateral is also being offered to the bank.

It is also a good idea to have a set of financial projections going out two to three years. Many businesses prepare several cases: worst, best and most likely (although they often show just one case to outside financing partners). This type of exercise will teach you a lot about your own business. Be prepared to explain the assumptions underlying the projections. If you cannot demonstrate that your company has strong prospects based on reasonable assumptions, you will not get very far locating a financing source comfortable with your company. But if you can, your chances of success are strong.

When you are looking for outside funding, be ready to answer these basic questions about your company and your needs. These answers will first help you find the most appropriate financing sources for your need and stage of corporate development. Then, they will help you get the best deal possible. Ready, set, grow!

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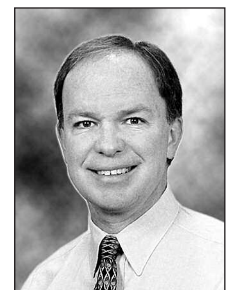

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