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5 Things Every Company Must Do When Seeking Capital

Date posted: November 30, 2016

Financing Your Small Business

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In my practice working with startup and growing companies, the first and most important question I am invariably asked is: How do we get financing and on what terms? Since being undercapitalized is the death knell for startups and not a good thing for any company, it is an issue which needs prompt solving. As any realtor will tell you, when selling a house it needs to be "dressed for sale." Fix the leak in the bathroom, patch the roof, add two coats of paint, replace the dead azalea and be sure the pictures on the internet show off the home to its best advantage. Now you are ready for the market. When dealing with the financial markets, advice from one-time Giant football coach Bill Parcells comes to mind: "When you get to the end zone, look like you have been there before."

So how do we get ready to "sell" the company to a lender, angel investor, private equity company and even to an IPO underwriter? The principles are the same. You need to make sure your "house" is in top shape first, by examining and preparing the following:

1. **Financial Statements**. Have accountants or sophisticated financial professionals prepare them. Don't try this at home kids. Always be sure the figures are mathematically accurate, based upon factually correct assumptions, cross foot, contain a balance sheet, income statement and statement of cash flow. Financial statements come in three varieties: Compilation, Review and Audit. "Compilation" is a gathering of financial information supplied by the company and put in a proper accounting format. It is not certified by an accountant and is the least reliable (and least expensive) variety. "Review" has critical evaluations of the clients' numbers to confirm a level of accuracy more than compilations. "Audit" has the financial evaluations which provide for accuracy greater than reviews and confirms accounts with the outside world of customers, vendors and creditors. In financing, it is worth the investment to get a review or audit. With startups, compilations work only for so long, and with commercial lenders, as opposed to angel investors, audit is required by Federal regulators.

2. **Financial Projections**. Please don't come up with the notion that the industry is $4 billion so all I need is 1/2 of 1% and I am home free to put $20 million of revenue on my projection. I have seen it and worse yet I have seen potential investors react to such nonsense. Talking about getting to the end zone – here is a chance to either look like a seasoned veteran or to embarrass yourself as a rookie. Detail is king. To determine revenue, make lists of customers and what they have purchased and assess the likelihood of repeat business, improved levels or losses for each one. Carefully provide the pipeline of future business, their potential contributions, estimated time of arrival and the pari-mutuel odds of success. Provide head counts, future hiring plans and the incremental costs of new business. Also, no investor wants to pay for unnecessary expenditures that are not essential to the business. So now is the time to get spouses, children, cousins and the nanny off the payroll. If you are not a cruise line, get the boat off the books and have the business charter it at market rates when you are doing business entertaining.

3. **Legal Audit and Review**. This is the time to get rid of your old Legal Zoom purchase and to fire your brother-in-law even if he did survive two years at The Spencer Business Institute. You need a competent corporate lawyer to do a soup-to-nuts legal review, including all charter documents, articles of organization, by-laws, stockholders or LLC operating agreements, all investor documents and correspondence, all deeds, leases, financing documents, equipment financing and purchase documents, vendor contracts, customer contracts, employment agreements, tax filings with IRS and appropriate states, pension plans, ERISA plans, any surveys, environmental studies, and all IP documents and correspondence relating to the company's trademarks, copyrights, patents and trade secrets. If the company has IP, give counsel the freedom to consult with your IP counsel to fully understand the landscape.

4. **Self-Assessment. Staging is everything**. Commercial Lending: Every commercial lender and every private equity player has stringent and inviolate rules of engagement. For the former, the rules are set primarily by the state or federal government in some form or fashion, the latter by the limited partners investing in the fund. So, if you are a mature company with audited financial statement and five years of profitability, feel free to approach either. Otherwise, they make no exceptions. With commercial lenders you need

to know rates but also terms, including the dreaded personal guaranties. Know too that while they will be doing extensive diligence on you, you should be doing extensive diligence on them. How committed are they to your industry? They may be heavily into your industry and are unlikely to pull out of their loans shortly down the road. If they taking a shot with you and are dabbling, BEWARE. My adage is that in bad times banks call good loans. The bad loans won't pay off. Check their track record on foreclosing on good companies (in bad times just about everyone is in technical default). Also read and get help analyzing your balance sheet. In exuberant times banks may lend at six times cash flow and in bad times they may think (or the regulators may think for them) that three times is the better number. Plan for such occasion by lowering leverage with additional equity and do it before the banks tell you to.(b) Private Equity: It is time for private equity if you are looking for a good and well heeled business partner to grow the company. In the best of circumstances, they provide internal growth capital to fund those critical projects. They are ideal too for those strategic acquisitions. Again, do as much diligence on them as they do on you. What have they done in the past, during economic downturns, missed projections, heightened competition?(c) Family, Friends and Angels: At the start stage you need to find folks who believe in you. Family, friends and angels. Put together the best operating team you can who show that you care about competence and depth, who can replace you if you are run over by a bus, and who can handle anything in you absence. A smart, well financed angel who believes in you is your best early stage investor.

5. **Aligned Interests**. Private equity players always make a fuss about interest alignment. Does the company and the equity prosper under the same circumstances? The principle is the same with the company's internal operations. Are the salespeople compensated on a percentage of monies collected not just accrued? No employee that I have ever known has sought to be paid by an assignment of accounts receivable. Are there incentives for proper inventory control? Is there a credit policy that allows for an acceptable degree of risk, which will maximize sales but at acceptable levels of write offs? Are collections part of an established policy and regularly monitored? It sounds mundane but anyone entrusting money into your hands wants to know that you are adept at the little things which matter so much in the aggregate. To echo Bill Parcells, you need to be skillful at blocking and tackling.

So whether you are looking for capital to start a company, to operate a company, to grow a company organically or to grow by acquisition or through your IPO, the principles are the same. Pay attention to details, be meticulous, be thoughtful and look like you have been in the end zone before!

Corporate attorney Murray Schwartz of Warshaw Burstein, LLP in NYC worked for 15 years as COO of a major media company, giving him a unique perspective on business strategies. He serves several companies as their regular corporate counsel and provides advice on a variety of issues including real estate, employment, trademark and copyright licensing, contracts, patents and IP, product development, investor relations and much more. Mr. Schwartz works very closely with clients, typically becoming involved at the earliest states of transactions.