Money Matters

A Guide to Small-Business Financing

AMERICAN EXPRESS OPEN FORUM® BUSINESS HANDBOOK

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Money Matters

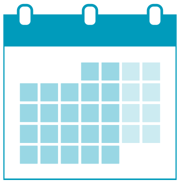
A Guide to Small-Business Financing

Introduction

Many small-business owners seeking to improve cash flow to fund a growing business don't want to give up any equity. Nor do they want to tap into their retirement accounts or ask family and friends for money. What other options exist?

The good news: There are many financing options entrepreneurs can use to help expand a business that may avoid the need to share ownership or put one's retirement security at risk.

In this guide, you'll find common situations where businesses may seek financing, provide an overview of the various debt-financing options available, help business owners understand these options and explain the importance of managing the financing received so that the business can continue to thrive and grow.



When Is It Time to Seek Financing?

A business owner may seek financing for a wide variety of reasons. For businesses in the growth stage, common situations that may require additional financing are:

Financing to meet demand

As demand for your product or service grows, your business may need to handle increased orders or clients. That requires purchasing or manufacturing additional inventory to fulfill those orders, hiring additional staff to provide services to more customers and/or hiring additional staff to fulfill the orders. Small-business owners might also need financing if they get a large contract or purchase order for which the business won't be paid until after the product or service is delivered. In this case, financing can help cover the costs of completing the work.

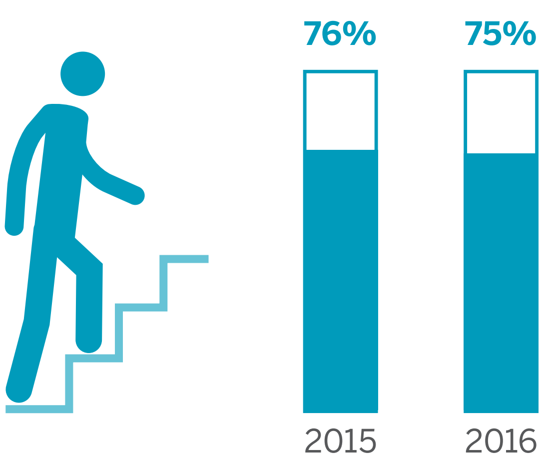
Financing for expansion plans

A business may have outgrown its current location and need to expand to a bigger one. Or it may be adding a second (or third, or fourth) location. Even if the business is not physically expanding its footprint, expansion to new geographic markets—whether regional, national or global—or to new demographic markets typically requires additional capital to support the growth.

Financing to invest in growth

A growing business may need financing to hire additional employees, invest in new types of marketing and advertising or purchase new equipment, vehicles or other assets.

SMALL-BUSINESS OWNERS PLAN TO GROW



Three-quarters of small-business owners plan to grow their businesses, steady year over year (75 percent, vs. 76 percent last year).

Source: 2016 American Express OPEN® Small Business Monitor

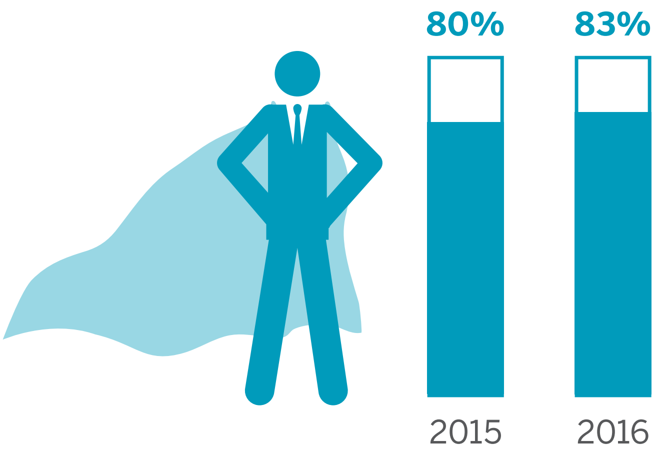
How Much Financing Do You Need?

The financing options available to small-business owners will vary based on the company's specific goals and its current financial situation.

To help determine the amount of money needed and what type of financing should be pursued, a business owner can start by working with financial advisors, including the business's bookkeeper and the accountant who prepares its taxes, to analyze the company's cash flow. Create detailed financial projections, including sales forecasts and cash-flow forecasts, to determine how much money is necessary to achieve planned expansion goals and for how long it is needed.

Armed with this information, small-business owners will be better prepared to make a smarter choice for financing their businesses.

SMALL-BUSINESS OWNERS ARE CONFIDENT



Compared to 2015, small-business owners are slightly more confident in their ability to access capital needed to grow their businesses (83 percent vs. 80 percent last year).

Source: 2016 American Express OPEN® Small Business Monitor

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Understanding Financing Options

TERM LOANS

Term loans are what many small-business owners think of when they think about borrowing for their businesses. In this type of financing, the business borrows money from a lender (typically a bank—brick and mortar, or increasingly online) and repays it in regular installments over a specified term.

Term loans are secured/collateralized and typically will take into account the business's credit score, how much of the required funding the business owner can put up, and a debt-coverage ratio. If a business needs a substantial amount of capital, a term loan may be the way to go; term loans can be extended for up to $1 million, $5 million or more.

Subcategories of term loans include:

- **Short-term loans:** this option typically has terms between three months and 18 months. Interest rates are generally higher than for longer-term loans, and the amount that can be borrowed is generally smaller.
- **Small Business Administration (SBA) loans:**
  - **7(a) loans**: the most common type of SBA term loan. While the specific terms of SBA loans are negotiated between a borrower and an SBA-approved lender, 7(a) loans can provide up to $5 million that can be used for a wide variety of purposes, including short-term or long-term working capital, to buy equipment or real estate or to construct or renovate a building.
  - **SBA CDC/504 loans**: available for up to $5.5 million and can be used for purposes including the purchase of land or buildings, making improvements to buildings or purchasing long-term machinery and equipment.
  - **Microloan program**: the SBA provide loans of up to $50,000 for terms up to six years.

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Two Brothers Bring Burritos to the People With a Guaranteed SBA Loan

When Leo Kremer and his brother Oliver opened their first Dos Toros Taqueria in Manhattan in 2009, the Bay Area natives cut any corner possible to stay within a bootstrapped budget. Without sacrificing customer experience, they got along with limited air conditioning and all used equipment. Now operating 11 locations in the Big Apple, the ▶

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brothers have funded fast growth with a Small Business Administration loan facilitated by a local bank and guaranteed by a small group of investors.

Getting the $5 million SBA loan with 10-year terms at a low rate wasn't easy, Leo says, but the financial discipline it forced was ultimately good for the business. Through the city agency NYC Business Express, the Kremers found a lender that helped them drive expansion and fulfill their mission of bringing San Francisco-style burritos to the people. Leo expands on that and more below.

What was the value in working with a local bank over the nine-month process of filing your SBA loan paperwork?

Human connection. Both lenders we met with sat down with us, spent a couple hours talking about where we've been, where we want to go and challenges and successes we've had. They took a careful look at our books in a way that a large bank might not. They saw that even if our second and third locations didn't hit, we could still cover payments with cash flow from our first spot.

What helped qualify you for that loan?

We worked with a small investor group that guaranteed the loan and took some equity for that, but not as much as if they had just given us the capital. That's a cool way to structure a deal with an investor who wants to maintain liquidity while giving you the discipline of loan payments.

Also, my brother Oliver and I own our apartments, so we personally guaranteed the loan up to our eyeballs. It's not for the faint of heart—but that's the price of getting a loan. In our case, it helped us get to 10 locations and was totally worth it.

What kind of funding are you looking at for future growth?

Instead of taking on more debt, we're looking at a more traditional equity route. Having a private-equity partner in place of loan payments frees up cash flow to open new locations and grow our team. Of course there are constraints to the agreement, but even with those provisions, protections and controls for the investor, it will help us to grow at a faster pace.

Any financial advice for aspiring entrepreneurs in the food space?

To the extent that you can self-fund, you should. If you want to bring in investors, a guaranteed loan structure works well. It's a lot less stressful for them to guarantee a loan than hand you a check. At the same time, you're building trust with the bank, which is positive.

We didn't start up with a food truck or cart, but that's a nice way to test out a fast-casual concept at a lower cost. If you're cooking on-site in a full-service restaurant, build-out and contractor costs for an exhaust system and other necessities are high. Everyone points to the high failure rate of restaurants, so it's much easier to break in if you know your concept has legs before you invest in a space.

To learn more about Dos Toros' business growth story, check out 5 Tips to Help You Handle Big Growth, Fast.

BUSINESS LINE OF CREDIT

A business line of credit may offer several advantages as a means of financing business growth. It may be unsecured, which means the business owner doesn't have to put up any collateral. In addition, the borrower doesn't accrue any interest or have to make any payments until the business draws upon the line of credit. Similar to a credit card, as the money borrowed is repaid, the amount available to borrow replenishes itself. A line of credit can be seen as "temporary" funding; it's especially useful when there is a lag between incurring costs and receiving revenue. Business lines of credit can be difficult to obtain, but if a business owner has a track record of success and good business and personal credit scores, this could be an option.

CREDIT CARD

Financing business needs with a credit card can be a solution for short-term financing needs. If a business owner has good credit, it's generally easier to obtain a credit card than some of the other financing solutions discussed here. The money needed can be accessed immediately, and the business owner may even earn cash back or other rewards from using the card. Credit cards also offer the flexibility to roll over the charges from month to month—so if the business's cash flow prohibits paying off the balance in full one month, all that's necessary is to pay the minimum balance to keep the account in good standing.

Keep in mind that interest will be charged on any revolving balances, as well as on balance transfers or cash advances, and these interest rates might be higher than for other financing options. Credit cards may also have spending limits that restrict the amount of credit the business can access. If a payment is missed or late, additional fees will be charged, and the card's interest rate may increase going forward.

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How to Grow a Year-Round Business in a Seasonal Seaside Town

When longtime friends and Brooklyn transplants Erin Johnson and Lucy Muellner opened Fork & Anchor general store in 2011, there was much to learn about the rhythm of doing business in a seasonal seaside community where sales can jump 300 percent from winter to summer.

Located in East Marion on the North Fork of Long Island, the shop sells provisions and simply prepared food made with local ingredients whenever possible, along with Fork & Anchor branded relish and other shelf-stable condiments. We spoke to Johnson about how she and Muellner have learned to balance the buzz and profit of summer with the quiet winding down of winter. ▶

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What insights have you gained from running a seasonal business over the past five years?

From Memorial Day to Labor Day, it's a whirlwind out here. The positive feedback we get during high season is rewarding, but the key is to maintain stamina and remember it's a marathon. It's a constant challenge to train seasonal staff, but we delegate as much as possible and keep things streamlined.

How do you manage cash flow through the year's ups and downs?

Like many seasonal businesses in the area, we have a line of revolving credit with a local bank that we can access any time of year. We pay off the $30,000 line during busy summer months and reactivate it for the slow season. It helps to have a personal relationship with the bank. We're in there every day, and it's good to know that they have our back. As we grow, we're also researching new local opportunities and are open to fundraising for future projects.

How do you grow your summer business to balance out the year?

We plan on capitalizing on the rush by opening Fork & Anchor kiosks at the local marina and at Orient Beach State Park in the near future. We also offer more catering and have expanded our online shop for customers who come to love our products during the summer and want to buy them online throughout the year. That's not a huge moneymaker, but it helps to grow our brand.

Have you found any other creative ways to capitalize on the summer market?

We just got a soft-serve ice cream machine and hope that drives some profit. On most days, we're open 6 a.m. to 6 p.m., but we'll stay open until 7 p.m. on Friday and Saturday nights this summer to serve kids and families out in the community after dinner.

To learn more about Fork & Anchor's business growth story, check out A Gourmet General Store Adapts to Modern Times.

CHARGE CARD

The term “charge card” is often used interchangeably with “credit card,” but there are some important differences.

First, charge cards require paying off your balance in full every month, so there are no interest charges to worry about.

Also, unlike credit cards that come with a fixed limit, charge cards come with no pre-set spending limit. And while this doesn’t mean unlimited spending, your purchasing power may adjust with your use of the card, your payment history, credit record, financial resources known to the issuer and other factors.

Business owners can use the buying power of a charge card to help pay for their everyday business expenses as well as larger purchases like inventory, raw materials, advertising, and equipment while getting rewards in return. It’s essential that before choosing this payment form, you feel confident that you’ve got the short-term cash flow to pay off your balance in full each month.

HOME EQUITY LOAN OR LINE OF CREDIT

A home equity loan or home equity line of credit (HELOC) is a loan or credit line that uses the equity in your home as collateral. If it is a loan, the entire amount will be drawn at the outset. If it’s a HELOC, the line of credit can be drawn on whenever needed, without incurring any interest or owing any payments until money is drawn out. In addition, as the money taken from the credit line is repaid, it’s available to borrow again. Home equity loans and HELOCs have become more difficult to get in recent years, but can still provide a good financing option for small-business owners with a lot of equity in their homes. However, it’s very important to be sure you can pay the money back—otherwise, you could lose your house.

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In Expanding Beyond Cocktail Bitters, Hella Co. Reaps Sweet Rewards

With the launch of Hella Bitters in 2011, co-founders Jomaree Pinkard, Tobin Ludwig and Eddie Simeon ramped up production of their home-brewed cocktail bitters, a flavor extract made from a concentrate of herbs and spices with spirits. Since their inventory has grown to include a Craft-Your-Own-Bitters Kit, an Old-Fashioned Kit and bottled cocktail mixers and syrups, they’ve evolved into Hella Company.

Now stocked by major retailers, they’ve come a long way since their early $2,000 Kickstarter campaign. After a very successful few days at a New York City ▶

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food show in 2013, they had to quickly triple production to meet demand. Stakes were high, and they needed to procure more spices, glassware, labels and equipment, basically overnight. Pinkard explains how Hella Company manages its growth by choosing the right payment method, transaction by transaction.

How do you manage your day-to-day cash flow?

We use Charge Cards with 30-day [Business Platinum Card® from American Express OPEN] and 60-day [Plum Card® from American Express OPEN] terms. With charge cards, we don't have a pre-set spending limit. While we take on risk with the obligation to pay it back within a certain timeframe, that flexibility is super beneficial from an operational standpoint.

How do you manage vendor relationships and decide on payment methods?

We use a blend of different strategies. We ask every vendor for at least net 30 terms and sometimes push to net 60. If we pay with a card, that gives us net 60 or net 90 days total.

Whether using a card or a line of credit from our bank, our objective in choosing a debt vehicle is always to align timing of outputs with inputs. If we have 60-day terms with a vendor, we'll use Plum. When we match liabilities with assets, there's no risk of a cash-flow crunch.

In managing your budget, do you sometimes lease equipment versus buy?

Our main equipment, like stainless steel tanks, has a long lifespan, so we've always bought. Over time, it pays for itself more efficiently than if we had leased. Generally, though, whether to lease or buy should depend on what the equipment is and how your business will use it. With a car, you might want to lease. Otherwise, you could always be fixing it. Or lease upfront and buy when ready.

Why is understanding cash flow at scale so important for new entrepreneurs?

If I buy a $5 lunch with my credit card but take 30 days to pay for it, it could cost $5.25. If I transfer balances from card to card, interest could be even higher. Once you throw compound interest on hundreds of thousands dollars, you're playing with big numbers. That's not wise.

People, equipment and raw materials all call for different debt or equity vehicles. Most small businesses don't understand that until they're in the trenches. Whether your business is small or large, as long as your cash flow is positive or even, you can be successful.

To learn more about Hella Company's business growth story, check out 5 Tips to Help You Handle Big Growth, Fast and What Next?

PEER-TO-PEER LENDING

In peer-to-peer (P2P) lending, you borrow money directly from individuals online, using websites that match borrowers and lenders. You'll complete a credit application to be listed on the website, then tell lenders why you want the money and see if you can get it. Many peer-to-peer lenders offer only personal loans, which isn't ideal for business purposes. Instead, look for peer-to-peer lenders that specialize in business loans—they offer more flexibility and also enable you to borrow more money.

While a P2P campaign looks a lot like a crowdfunding campaign, as both involve individuals financing other individuals, there's an important difference: In crowdfunding, the money that individuals put up is a donation to or investment in the business, or pre-paid orders for an as-yet-unreleased product, whereas, P2P lending is not a loan that must be paid back.

P2P lending has generated some controversy in the news lately, but as with any financing, potential borrowers are advised to conduct due diligence on any potential lenders, to make sure they are reputable, have good customer service, have a customer-friendly application process and have received positive reviews from their borrowers.

WORKING CAPITAL ASSET FINANCING

Also known as accounts-receivable financing, inventory financing or factoring, this type of financing enables a business to turn its accounts receivables into cash that can be used for working capital. The financing source either uses the accounts receivable as collateral for the loan, or purchases them outright for a percentage of face value (typically about 80 to 90 percent). The business receives the cash right away. Depending on the terms of the arrangement, the financing source may even handle collecting on the outstanding invoices. Once the invoices are paid, the financing source gives the business the remainder of the invoices' value, minus a fee.

LEASING

Companies that need new business equipment or vehicles can avoid a big cash outlay by leasing the equipment instead of buying. Leasing helps maintain strong cash flow because a down payment on the equipment is not required. It may also be possible to structure the lease in such a way that it doesn't show up as debt on the business's credit rating. In addition to these financial advantages, leasing may also enable a business to have the most up-to-date equipment, which can help give it a competitive edge. Leasing criteria are generally similar to those for a term loan from a bank. However, if you work with the leasing arm of the company that makes the equipment, they may have a greater incentive to work with you because they want to make the underlying sale.

PURCHASE-ORDER FINANCING

If a business has received a big purchase order, it may be possible to use purchase-order financing to cover the costs of fulfilling the order. In purchase-order financing, a lender advances a business the money to cover the cost of products or services that a big customer has ordered. The more reputable the customer and the better their track record in making timely payments, the easier it can be to obtain purchase-order financing. The business must also demonstrate to the lender that it has the ability to fulfill the contract. It may be a good idea to structure the sales agreement so as to minimize the customer's ability to cancel the sale. Keep in mind that when the product or service is delivered to the customer, the purchase-order lender will want you to pay off the financing. It's important to make sure there is adequate capital on hand to do so, even if the customer isn't going to pay the invoice for several more months.

VENDOR FINANCING

Vendor financing, sometimes known as vendor credit or trade credit, is something that many small businesses already use. A company that buys products or services from other businesses and doesn't have to pay for them right away is using vendor financing. It may be possible to finance business growth plans by getting better credit terms from existing vendors, or seeking new vendors that offer better credit terms. For example, if a current vendor wants invoices to be paid in net 30 (30 days), seeking a vendor that offers net 60 terms (or negotiating such terms with the current vendor) would enable the business to keep its money longer. Some vendors even let businesses maintain a revolving balance in their account, similar to a credit card.

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Interior Design Clients Buy Directly From Vendors, and Everyone Wins

During her first decade in business, managing cash flow was a challenge for Jeannine Williams, the owner of Jeannine Williams Design. Using a trade account to buy from vendors for her upscale New York interior design firm, Williams floated purchases on her own credit cards and waited for client reimbursements. As her business grew, pending invoices and bills piled up. Her small staff struggled to keep up with the repetitive paperwork, and Williams knew she had to find a more efficient way to operate. ▶

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Then came the recession of the early 2000s—and everything in her industry changed. Once-restrictive vendors simply wanted to get paid. Whether by check or third-party credit card, they accepted payment however they could get it. Now it's industry standard for clients to cover costs with their own cards and reap the rewards. Buying directly gives clients a sense of control, expedites purchases and allows them to rack up points. People like to make their money work for them, as Williams points out, so we asked her to expand on that and other financial wisdom gained during her 25 years in business.

Now that vendors accept your clients' credit cards, what are benefits?

Purchasing is now much easier and faster. I don't have to generate purchase orders in-house and bill vendor invoices out to my clients. I spend less time on accounts receivable and payable. In the past, I had to invoice clients and wait for a check to arrive. Now that they use their own credit cards, purchases can happen immediately.

In growing your business, have you taken on investors?

I've had a few inquiries, but I've been stubborn about staying independent. Interior design is a luxury business, and luxury trades are the first to go when the economy dips. I've sustained economic transitions in part by being very cautious about sharing ownership.

As an alternative to taking on investment, how have you managed your budget?

For an added cushion, I've used a bank line of credit. I've always had a six-to-12 month cushion I can pull from.

Any tips for negotiating with vendors?

If I'm working on a large house and my client likes a specific designer, I'll say directly to that designer, "We'll buy from you for 90 percent of this project." In doing that, I've gotten concessions, like another 10 percent off my trade discount. You have to be very direct in communicating with vendors. I'm not afraid to ask for a discount because I know what I'm bringing to table.

Along with large companies, you also work with individual craftspeople. How do you adapt to their financial needs?

Some of these artisans operate on a project-by-project basis with very slight profit margins. I want to keep them in business, so my job is to educate clients to pay a fair price. If a client doesn't understand what goes into fabricating custom bookcases or cabinets, I'll suggest a redesign to meet a revised budget. My vendors work hard for me because they know I would never play around with their finances. I make sure they earn what they should, and they help me in any way they can.

To learn more about Jeannine Williams Design's business growth story, check out For This Interior Designer, Relationships Come First.

Choosing and Managing Your Financing

The best source of financing for a business's needs will vary depending on the amount of money desired, the time frame for which it is needed and the company's specific circumstances.

When comparing financing options, make sure to clarify all the terms of each type of financing—including not only the interest rate, but also the annual percentage rate (APR), prepayment penalties, fees, impact on the business's credit score, lender's reporting requirements and any other conditions. It's important to make sure that any debt a company takes on is worth the cost and will deliver a good return on investment.

Once you've received your financing, you should carefully manage your credit and cash flow so you can maximize the benefits you obtain from the financing. The following are some important considerations.

Make payments and fulfill any reporting requirements on time.

This can help to avoid problems with the financing source and build the business's credit rating. Also, developing a business relationship with the creditor can be beneficial. For example, if you come up short in a repayment, you can call and discuss when you will be making the next payment.

Use the cash-flow statement to stay on top of business finances.

Reviewing the business's cash-flow statement weekly can help to make sure the company is on track to achieve the goals in its cash-flow forecast. If cash flow is lagging behind expectations, consider steps to get it back on track. This can be done by cutting expenses, raising prices, and/or being more aggressive in collecting on accounts receivables. This will help to avoid cash flow "surprises."

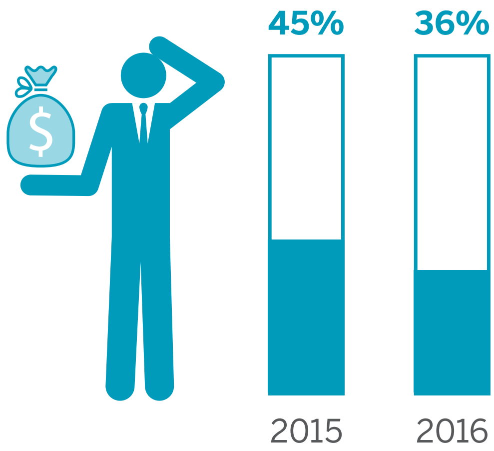
Tap into the expertise of financial advisors.

Enlist the company's bookkeeper and/or the CPA who prepares its taxes to help manage the financing proceeds effectively. Businesses may also benefit from seeking out a free mentor, such as those at SCORE, to help. These advisors can provide advice to help maintain solid cash flow and take the necessary financial steps to achieve desired business growth.

Staying on top of your cash flow helps to ensure that you can repay your financing source, which maintains your account in good standing, improves your business credit rating and makes it easier to get additional financing in the future.

It also helps you assess your future financial needs and plan ahead for them, so you can prepare to seek additional financing well before you need it. By carefully tracking your cash flow and monitoring your business's financial growth, you can make the most of your money, investing it wisely to achieve your business goals.

SMALL-BUSINESS OWNERS' CASH FLOW CONCERNS LESSEN



Small-business owners' concerns around cash flow are down (36 percent vs. 45 percent last year).

Source: 2016 American Express OPEN® Small Business Monitor

Resources

These resources may be helpful for additional information on financing options.

- SBA Government Loans and Grants Resources https://www.sba.gov/loans-grants
- BusinessUSA Access Financing Tool http://business.usa.gov/access-financing
- SCORE Business Financing & Loans Resources https://www.score.org/content/financing-and-loans-resources

To learn more about how products from American Express OPEN can help you grow your business, please visit americanexpress.com/us/small-business.