How to Structure Your Business Capital

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Any entrepreneur who has been in business for any length of time knows that it takes capital to run a successful company. But some business owners get so caught up in the product development, manufacturing and distribution, or sales and marketing side of their company that they neglect the critical task of structuring their business capital.

Doing so can be a big mistake — because more companies fail due to a lack of capital than due to poor products, inadequate manufacturing and distribution processes, or ineffective sales and marketing. Therefore, it's critical that you and your financial managers spend time carefully planning for how you will meet your company's capital needs now and in the future.

Different Business Uses, Different Types of Capital
Central to this process should be a plan for how you will structure your business capital. There are many different uses of capital in a business — from growth capital to working capital to capital used to purchase additional inventory. Different types of loans are used to meet these various needs, so you need a broad plan for structuring capital that ensures the right loan is used in the right situation.

There are three main types of capital available to businesses:

1. Debt — Here, we're talking about traditional loans, usually from a commercial bank. In addition, there are many online lenders today that provide business loans, such as OnDeck.com and Kabbage.com. Business loans usually take one of the following forms:

***Term loan**:* An amortizing loan typically used to finance the purchase of fixed assets.

***Line of credit**:* Enables business to borrow up to a predetermined amount at any time without reapplying.

***Lease**:* Typically used to acquire equipment like computers and heavy machinery.

***Commercial mortgage**:* Used to finance the purchase of new or existing commercial property.

***SBA loan**:* Designed for small businesses that might not qualify for a traditional term loan or line of credit.

***Asset-based loan**:* A loan against the assets of your business, especially accounts receivable and inventory. It is a form of secured loan, and therefore, is not heavily dependent on the business's net income.

2. Equity — With this type of capital, you will be giving up shares of ownership in your company in exchange for capital from investors. You do not have to repay the capital to your investors like you do a bank loan; you are "buying" capital and the price is equity in your company.

At first glance, equity capital might seem very attractive since you don't have to repay it. But you need to think long and hard before selling business equity — because doing so dilutes your ownership in the business. Also, equity investors sometimes want to be actively involved in businesses they invest their money in, so you should be prepared to possibly relinquish some control of your company.

3. Organic Growth — This is represented by retained earnings, which is the accumulated income from your business that isn't paid out in dividends or owner's compensation; or in other words, earnings that are retained in the business. Generating financing internally by tapping retained earnings is usually the most attractive capital option because it doesn't involve borrowing money from a bank that must be repaid with interest or selling equity to investors. Therefore, you should usually pursue this option before seeking a bank loan or equity investors.

To increase your retained earnings, you should focus on shoring up basic business and financial management practices like increasing sales and improving cash management. This includes staying on top of your accounts receivable, effectively managing your inventory, and negotiating with your vendors to make sure you're receiving the most attractive payment terms.

Financial Statements Are Crucial

Regardless of how you decide to structure your business capital, it's critical to make sure you have accurate and credible financial statements and forecasts. These will form the basis upon which both banks and venture capitalists make decisions about whether to lend money to or invest in your business. Also, you will need accurate sales and cash flow forecasts to generate internal financing via retained earnings.

An outsourced CFO services provider can help you determine the most appropriate capital structure for your business. In addition, an outsourced CFO can help ensure that your financial statements and forecasts are suitable and ready for review by bankers and investors. This professional will bring a level of financial sophistication to the equation that few small and mid-sized business owners or their financial staff possess, thus helping ensure that the most advantageous capital structure is put in place.

Concluding Thoughts

It takes capital to run a successful company, but some owners get so caught up in the other aspects of running the business that they neglect the critical task of structuring their business capital. Doing so can be a big mistake since more companies fail due to a lack of capital than poor products, inadequate manufacturing processes or ineffective sales and marketing. So, it's critical that you and your financial managers spend time carefully planning for how you will meet your company's capital needs now and in the future. An outsourced CFO services provider can help you determine the most appropriate capital structure for your business.

About CFO Edge

CFO Edge, LLC delivers enterprise-class financial and operational performance solutions to executives throughout Southern California. Based in Los Angeles, our formerly-seated chief financial officers engage on demand as part-time CFOs, single-project CFOs, and interim CFOs to help business leaders successfully resolve pressing challenges and realize their financial and operational goals. At CFO Edge, we are passionate about helping our clients create, grow and sustain value. For more information, visit www.cfoedge.com or call 800.276.1750 Ext 101.