

F U N D I N G

GROWTH

By
Julie Garella



The *right* kind of capital
is vital to business development.

For a growing business, capital is the equivalent of oxygen. But all too often, businesses start out undercapitalized and fail to take the necessary steps to ensure that growth opportunities will not be missed. Taking other people's money, however, is not for the faint of heart. For with that comes not only the expectation from investors that you will meet annual growth and earnings targets, but the understanding that your company is an asset in their portfolios, and must be handled in a businesslike manner.

When you put your money in a mutual fund that invests in publicly traded companies, you expect to get a certain return over a certain period of time, and of course, you want to be able to get your money out. The same goes for venture, mezzanine, and private equity funds. Think of these sources of growth capital like a mutual fund for institutions that want to invest in private companies. They have criteria as to the stage, size, and often the industry or geography, which guide their investment decisions. And they also have return hurdles that they must meet for their investors who, in most cases, are limited partners in their fund.

Depending on the size and stage of your business, certain types of funding will be easier to get than others. While seed money may come from angel investors, real expansion capital is likely to come from private equity and buyout funds. Unique to all investors is the idea that they are backing a growth company.

In terms of growth, most entrepreneurs tend to fall into two categories: lifestyle makers or empire builders. No matter which category you find yourself in, chances are you started out like all successful entrepreneurs, with a good idea

and lots of energy. As your company grow and matures, you will find yourself at forks in the road along the way. The personal and emotional factors that go into making the decisions at these moments are what determine into which category you fall.

So, when thinking about seeking growth capital, ask yourself: Am I a lifestyle maker, or am I building a business empire? Here are a few ways to distinguish one from the other.

Lifestyle Maker

Typically started the company without a real plan in mind; is an owner who is happy doing it his/her way; is unconcerned with the external environment; lives quite comfortably, usually both monetarily and as an established member of the community; has no real exit strategy; is a people pleaser; has blurred lines between the person and the company; and relies mostly on instinct.

Empire Builder

Plans the work, works the plan; is acutely aware of the competition and the business landscape; understands exactly what needs to be done each and every day to create the most value for the company; leverages contacts and resources; maintains a divide between business and emotion; and relies mostly on research and empirical evidence for decisions.

Should you decide that you are an empire maker, then you have taken the first step toward preparing yourself to take on outside capital. A good venture capitalist friend of mine likes to say that to be successful at raising growth capital, a company must have the five M's—management,

market, money, mettle, and magic.

M*Management* is the single most important factor in determining whether or not you are investment worthy. In business, it's all about management, management, management. Look at your current team in light of how you are going to execute your plan once you get funded. If you had the money today, are these the people that you would choose to move the company forward? Frequently, the team (including yourself) that got you to a certain level is not the team that can execute on the accelerated growth goals that an investor wants to achieve.

Be realistic and, if you need to, shore up the management team now, or at least identify key players who would be willing to come on board at the time of funding. I often think of the entrepreneur as the centrifugal force that holds the company together, steering the values, vision, and culture of the organization. All around this force are the members of the team that make it happen. Key players from the investor's point of view will be in finance, operations, and, depending on the type of business, merchandising, sales, and product development. Without this team in place, or at least identified, it will be difficult to convince investors that you can execute.

M*Market.* Next, understand what investors mean when they ask you about the market. If you have developed proprietary accounting software for the financial services market, don't talk about the market for accounting software in general. Likewise, are you a market leader or at least well-positioned to overtake the leader? Investors are looking for companies that offer products and services that fill a void or solve a problem better

than what is currently available. If you don't have competition or are not solving a major problem, then there's probably not a big enough market to offer investors a suitable return.

M*Money.* You need to be making it. In today's environment, it is all about growing the bottom line. Margins matter here, too. Investors are interested in companies that they believe can grow their market share and increase their bottom line, or EBITDA growth (earnings before interest, taxes, depreciation, and amortization), without eroding margins. If your strategy is simply volume, or to sell more, that will not be attractive to potential investors. Here's why. Low margin businesses offer no cushion in the event of a business downturn or miscalculation of the plan. Additionally, it is a sign that customers do not value the products or services and are not willing to pay a premium for them. Which would you bet on, the horse that always wins by a nose, or the one that finishes lengths ahead of the competition every time he races?

M*Mettle* is the strength that it takes to work your plan each and every day. Owning a business is not easy. When you own a business, you are the one who stays up at night sweating the payroll, figuring out how you are

going to finance the next big move, and worrying about the competition. And, when you take on the task of raising capital, and answering to a board and investors, you have just raised the bar tenfold. Just as some employees could never own a company because they don't want to worry about whether or not their check will be there on Friday, not all business owners have the fortitude to take on the fiduciary responsibility of other people's money.

M*Magic.* This is the last piece of the puzzle. It is the "intangible extra" that lets the investor know that you and your team have what it takes to hit a home run. Call it magic, or call it chemistry, but every growth company that gets backed has something that their investors think will be the secret to their success.

So why does a company take on growth capital in the first place? Remember, business is about money, and it takes money to make money. Companies like Tiffany & Co., Dunkin' Donuts, and PayPal all had private equity behind them. Virtually every company you can name that has been able to grow exponentially has been able to do so because it was well capitalized. Ask yourself, who are your biggest competitors and why? Chances are they are companies to which your customers

feel more comfortable giving larger orders. Why? Because the larger order is not going to strip them of all of their resources, either in terms of financial or human capital. Their management team is sophisticated; they can afford the systems and controls necessary to get the job done. Why? Because they have money.

How does a company decide if it can be successful at raising growth capital? Speak with an investment banker. Investment bankers typically are paid only a small fee up front. They earn their money from successfully completing a deal or a capital raise, so the good ones will tell you honestly what they think the chances of success are, and what you might be able to do before hiring a banker to help insure that success.

Don't try to go it alone. All too often we hear from companies that a slew of investors have been after them, offering to give them capital. The reality is that, most of the time, these discussions have not gotten to a serious level, the prospective investors have not had an opportunity to look at the financials of the company, and the company has not been properly prepared to speak to investors. Remember, raising capital is a time-intensive process. There is a reason that the big companies, banks, and even investment banking firms themselves hire outside firms to represent them when they are working on a transaction. ♦

Julie Garella is the managing partner of McColl Garella, LLC, an investment banking boutique focused on woman-owned and woman-led businesses with revenues of \$10 million or more. For more information about her firm, visit www.mccollgarella.com.



Appropriate Capital Sources: By Business Size and Stage

Stage	Capital Need	Source
Start-up, Pre-Revenue	\$0-\$500,000	Friends and Family
Seed	\$500,000-\$5 million	Angel Investors and Funds
Early Growth, EBITDA Positive	\$5 million-\$20 million	Venture Capital Funds, Mezzanine Lenders
Expansion	\$20 million +	Private Equity, Buyout Fund