Financing and Managing Business Growth

The Stages of Growth

For companies just starting out, the last place to end up is at the bank. Although access to capital is consistently the most insurmountable obstacle facing minority- and women-owned businesses, the way to get more capital for your business is to start out with it. “Banks don’t give money to companies that don’t already have it,” points out Kneeland Youngblood, managing partner of Pharos Capital. “For MWBEs, the problem is that they often lack the personal connections that can get them up and running in the first place, but without them, their businesses may never get off the ground.”

At the early start-up phase, what you need are “angel funds”—monetary gifts or loans from friends and family.

If you don’t have wealthy friends or family, another option is to fully rely on yourself and take out a loan, or borrow against the equity in your home or other major possessions. For Jim McKinley, president and founder of McKinley Financial Services, currently the largest African-American insurance agency in the United States, starting and then growing his business required a lot of very personal sacrifice.

He took out a home equity loan to start his business, and for the first four years, reinvested all of his profits back into his business, paying himself only $30,000 a year—something a lot of people aren’t comfortable doing. Even still, the odds of a small business surviving are still a paltry 15-20% because so many cannot financially recover from unforeseen eventualities like mild winters for a company that sells cold weather products.

But once McKinley made it past the rocky, formative years of his business, developments happened much more smoothly. Indeed, once a business has steadied itself and shown consistent profits—often by the sixth year of operations—approaching a bank to get a line of credit for a rainy day fund, is definitely a good move. Keep in mind, however, that you can’t reach out without established relationships with managers at the bank because you will need an advocate who understands your business, sees your potential and is willing to go to bat for you.

“People do business with people they know,” says Youngblood. “You can have a great business plan and a great team, but if you lack a good relationship with a lender, all your effort is for naught.” Also consider approaching a local bank if your needs are more modest. If your needs are great, try commercial banks, which offer a wide variety of financial services. Whatever your choice, make sure you thoroughly shop around.

And even when you get that loan or line of credit from a bank, the cost of that money is often expensive with high interest rates and the looming risk of bad credit if you default on a loan. So before you go to a bank, make sure you have a solid plan in place for repaying any loans.

Additionally, when you ask for funds, be firm about how much you really need, why and how this investment in your company will be good for business—and for your lender. “Sometimes a small business owner will ask for $500K, but when I tell them they’re only likely to get $200K, they say that’s fine too. Well, for me as the lender this sort of wishy-washy answer makes me think the business owner hasn’t done his or her homework,” says Robert Emerson, senior vice-president and chief lending officer of the Business Consortium Fund (BCF), which is not a direct lender, but represents a cadre of some 60 banks throughout the country and often steps in to assume as much as 75% of the risk with an MWBE so that one of the banks in their consortium feels comfortable enough to make a loan that they may have otherwise passed on.

“You must be realistic and grounded in what you ask for,” says Emerson. “We want a crisp story of what you’re asking for and why, and how you plan to repay. A lender wants to have confidence in you, and both parties want to prosper.” The key pitfall in financing your growth is being over-leveraged: owing more than you own.

If going to a bank doesn’t work or if you’re not yet ready for it, consider other types of capital such as venture funds, or an equity capital fund, short-term lines of credit available for just one year, or even term loans that in the case of BCF can last up to four years.

One of the most fundamental aspects of growth is capacity building—but this isn’t something many lenders are open to because it is a significant investment of time, capital and resources. One lender—Wachovia Bank, with branches in 21 states and Washington, D.C.—was one of the first to offer a capacity building initiative to its diverse suppliers. The bank, says Bert Carrington, Wachovia’s supplier diversity coordinator, and vice-chairman of the Financial Services Roundtable - an NMSDC industry group dedicated to helping MWBEs- identifies companies with good prospects for growth and then brings in outside consultants to conduct a growth strategy and analysis.

He offers the example of Urban Settlements, which is a minority vendor that manages appraisal services. Wachovia assessed the company’s strengths and weaknesses and paired it with an eight billion dollar company that bought 35% of Urban Settlements—allowing it to retain its MWBE status—but allowing both companies to sit in on often large bids that Urban Settlements would otherwise not have been exposed to.

Because of this partnership, Urban Settlements is positioned to grow from a five to fifty million dollar business. “We are focused on growing our diverse suppliers so that they can compete for large procurement bids alongside highly competitive, huge national firms,” says Carrington. “MWBEs need to take a cue from corporate America and realize that partnerships and mergers and acquisitions is the way to go.”

Outside of the various stages of growth, Pharos Capital's Youngblood offers a few key requirements for MWBE managers seeking to grow their businesses: get all the appropriate qualifications, including a good education; build a strong network of contacts; acquire substantive work experience; and make sure your product is substantive and that your company is competitive.

Key Risk Factors

Once you're ready to expand your business, keep in mind some common pitfalls.

One thing all of our experts agreed on, was that MWBEs must be careful of growth that is too much too soon. If you can't properly service your customer base, or if your profits are barely covering your operating costs, this could be a significant risk factor for your business.

It will therefore be crucial for small companies to slow down, and grow thoughtfully for the long run. Some of the lessons of enterprise risk management are particularly helpful because procurement officers from corporations will ask suppliers if they have back-up plans in the event of a disaster, or if their business structure is sound and if they plan to be in business for many years to come and have begun thinking of a longer-term growth plan as a result.

Another worrisome risk for small businesses as they grow is ensuring that they have enough quality staffers to take their company forward. Bottom line, says Jim McKinley, is that any MWBE manager has to make a full-time commitment to their business. "You'll have to give up the 9 to 5 safety job if you really want your business to succeed," he says. "You'll have to commit yourself full-time to your business and go for it. There will be pitfalls, but also the chance of a very rewarding success story."

In a more basic sense, MBWEs can navigate their way around risk by surrounding themselves with trusted advisors who complement their own experience and expertise. "A board of advisors is very important," says Wachovia's Carrington. "No one person knows everything. Having diverse professionals in your midst like an attorney, CPA, a market specialist, someone with experience in corporate procurement, could be invaluable in helping steering you clear of trouble."

Other ways to ensure that your business can withstand stormy weather, is to invest in technology that allows you to provide cost-competitive services in a globally competitive marketplace. For instance, MWBEs that are paid through an electronic data interchange (EDI) system, can receive monetary payments instantaneously. Make sure you research current technologies in your business area, and also look into what technologies you can download for free to cut costs. "Technology is your friend, not your enemy," says Carrington. "In a quickly flattening world, technology allows people and companies to connect in an entirely new and important way. Be sure your company is fully on board with technological advances."

Other ways to stay ahead of the curve include closely studying market trends so that your business is always ready to respond to the next great new thing. But ultimately, have faith in your competitive advantage as a minority supplier. “Companies see it in their own enlightened interest to encourage the use of diverse suppliers,” says BCF’s Emerson. “At BCF, we believe that companies should recognize the importance of good financing for any supplier diversity initiative and see ourselves as a partner for corporate procurement programs because the landscape is only going to get more crowded with new MWBEs that are responding to shifting U.S. demographics.”

And even in an increasingly globalized world, says Pharos Capital’s Youngblood, MWBEs often have a greater sensitivity to other cultures and to differences in general, and their niche understanding of growing market trends in increasingly more diverse communities, provides minority- and women-owned businesses with a number of unique advantages.