Capital-Asset, Cash-Flow Sourcing Differs *(IW Growing Companies, December 1998 issue, page 20)*

When sales volume in a small manufacturing company strengthens, two categories of growth capital must be sought. The firm needs additional working capital to cover the newly expanded timing gaps between greater upfront production costs on new output and any increases in trade credit to new buyers that often accompany strong sales growth. But the company also will need to invest in plant and equipment. Because these are not the same types of growth capital, business owners need to know the difference between priorities associated with cash-flow providers versus funding for capital-asset acquisition.

Senior management must care-fully weigh the pros and cons of dealing with various levels of growth-capital providers. There are times when both types of growth capital may come from the same source, but, more typically, entrepreneurs will have to deal with two distinct parties when formulating their growth-funding strategy. It's puzzling to note that it is often much easier for smaller firms to secure capital for asset acquisition than it is to locate a consistent source of short-term working capital. This is generally due to the perceived stability of the time frame for major plant and equipment commitments, as opposed to the volatility (and uncertainty) of shorter-term working capital.

Funds used for asset acquisitions come from commercial banks, leasing firms, Small Business Administration loans, small venture investment groups, or large venture-capital companies. Many funding deals also involve a consortium of private investors, businesses in the same industry, larger suppliers on the back end of the marketing chain, or the bigger distributors on the front end of the channel.

Introductions to these various tiers of funding will set the tone for the course of negotiations. These providers want to invest in tangible assets (machines, buildings, trucks, and equipment). They are not interested in backing new product testing or research and development. Their top priority will be linking the invested funds to asset values. If a smaller manufacturer can demonstrate significantly increased profits based on greater output capability, setting up a funding deal will be relatively easy. The main issues will focus on debt versus an equity stake and timing of the pay-back or exit strategy.

The prospects for securing growth-oriented working capital may actually be more tenuous than for asset-acquisition funds. Commercial banks and finance companies that factor new receivables are not all that different from each other. They both want to see a certain quality of new "paper" in hand before they will commit. But sometimes the best working capital deals come from other owners of companies directly linked with the manufacturing scope of your business, those companies looking for places to park their near-term positive cash flow—if it can beat the rates offered by banks and mutual funds.

However, offering larger companies one or two full percentage points above the current money-market rates may not always be enough to interest them in your cash-flow funding needs. They may only want to provide working capital on an "as-needed" basis, which often means they want to screen your prospective new purchase orders case-by-case before they decide to commit funds. This can become very cumbersome and limit a smaller firm's flexibility to respond to new orders. And it is not uncommon for larger companies to sometimes have different timing cycles on their own cash flow, which can conflict with the days when cash flow is needed by the smaller firm.

Supporting increased manufacturing output through asset acquisitions is very different from making excess cash flow available for 60 days or 90 days four or five times per year. Though these are both vital components of any company's growth-capital strategy, the providers have different priorities and expectations regarding your growth performance.