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How to handle the costs of your startup to maximize success

Opportunity: a situation or condition favorable for attainment of a goal. Large, small, new or old, opportunity is what all businesses seek. So what makes a situation or condition "favorable"? What is the cost of "opportunity"? What is the cost of lost or missed opportunity? As a start-up business, how do you know how to calculate these costs? What effect does your ability to calculate these costs have on the success of your business?

The good news is the 2015/2016 Global Entrepreneurship Report published by Babson College and others show that 80 percent of new businesses actually survive their first year. The bad news, however, is 50 percent exist after five years. So what happens between year one and year five? The simple answer is they run out of cash. One of the first things I learned when I started my first business over 27 years ago was cash flow is the life blood of your company. Furthermore, I realized I can't do everything, so the first employee I hired was a bookkeeper. Which leads me to the second thing I learned in business, you have to know your numbers.

In my business, we get applications every day from companies that do not have accurate financial information. Their balance sheets don't balance. They do not have up to date accounts receivable and accounts payable agings. They do not have a profit and loss statement. How do you know how to price jobs or products if you don't know if you're making or losing money? Our finance company, CapitalPlus Equity, LLC has received many applications for working capital that do not have the proper financials so several years ago we started offering these back office support services through CapitalPlus Financial, LLC in order to solve this problem for new and growing businesses. We set up the client on QuickBooks Online, enter all the data, such as invoices and bills and reconcile the bank statements at the end of each month. The owner of the company (our client) can log onto QuickBooks Online at any time and see how they are doing. We teach them how to pull A/R and A/P agings so they can tell who owes them money and what bills need to be paid, but more importantly, it lets them see if they are making or losing money. This at least helps answer the question "what is the cost of opportunity" and "how to calculate the costs of opportunity." Once we help them get their finances in order, CapitalPlus Equity, LLC is much more likely to be able to assist them with working capital to help them grow their business.

What other risks affect the cash flow of your company? The answer is simply how quickly you get paid for your product or service. If you are selling products or services to a client and offering them terms (30, 45, 60 days to pay), you are essentially giving them credit. How do you know the client is willing or able to pay within these terms? What happens if they don't pay for 90 days or longer? Can your company survive? We always advise our clients to get as much information as possible before giving terms to a client or before bidding on a large project. Just because you are bidding on a job with a large contractor doesn't mean that the contractor pays on time. They may have a history of paying 120 days or longer. They may have tax liens and judgments against them. Wouldn't you want to know this information prior to bidding on that large project? Our clients have us pull commercial credit reports on their clients to assess the risk associated with working with the potential client. Winning a million-dollar client can be that opportunity you've been waiting for, or it can also be that misfortune that puts you out of business. Know your risks before you enter into a contract.

So you have your accounting system, you know your numbers, you assess your risks before bidding on contacts and you've been in business for a while. The next step may be obtaining working capital to grow your business. There are several options for obtaining working capital. If you have a good relationship with your bank, it will most likely be your least costly option. However, banks look solely at your company and you as an owner to determine whether to make the loan and for how much. And while the cost of the working capital may be low, the amount the bank is willing to loan may not be sufficient to cover your working capital needs. Bank Lines of Credit are usually only valid for one year and need to be renewed annually. If you win a large contract and/or need to request an increase to your line, the approval process usually takes as long as it did to get the loan the first time. Crowdfunding, online start up business loans, merchant advance loans and factoring companies are some other options for working capital.

Crowdfunding is raising small amounts of money from a large number of people. This is almost always done through some kind of crowdfunding website, such as Kickstarter or gofundme.

Some startups rely on the strength of their business or campaign, believing that their product will attract contributors. Others offer rewards or incentives to supporters in exchange for their investments. There are still other options that actually offer shares of the business to supporters in exchange for their investments. Cost for this option is typically 5-10 percent of total money raised plus offered incentives/rewards (gifts, share of business, etc).

Online Start up loans are much like bank loans in that they look at your credit and ability to repay. The turnaround time is usually a little quicker than a bank but the rates are much higher. The terms are typically 12-24 months to pay back the loan.

Merchant Cash Advance loans require very little documentation to get approved. They want to see bank statements for a period of time to determine the average amount of deposits made each month. These companies will then determine how much to loan you based off of the amount they can successfully withdraw from your account each and every day for a specified amount of time (usually 12 to 18 months). I strongly suggest anyone use this as an absolute last resort. I have seen this form of financing put many companies out of business.

Factoring companies, known as Factors, will finance your working capital using your accounts receivables. Once you send an invoice to your client they become a debtor. They owe you the amount of the invoice. Factors will advance you a percentage of an invoice (example 80%) and once they are paid back by the debtor (usually 30 days) they take out a small fee and send the balance of the invoice back to you. Factoring is also much quicker than using a bank. Once you have established your account, you can usually get funding the same day you submit your invoice to the Factor. One of the biggest advantages to using a factoring company to finance your working capital is that a Factor will not typically set a limit on your borrowing like a bank does. Factors will look at each project and the debtor's ability to pay.

Being able to calculate costs is essential to the survival of your business. Understand you do not need to know how to do everything, spend your time doing what is best for the company and outsource the rest. Know your numbers, assess your risks and always, always remember cashflow is the life blood of your company. Best of luck and much success with your startup!

Scott Applegate is the chief operating officer for CapitalPlus, which includes two financial services companies focused on helping new and growing businesses.