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Dollars and Sense

PROFIT 200 firms live and die by their ability to fund operations and growth. Here are their smartest approaches to finding financing

Jim McElgunn || June 19, 2012

Kurt Hibchen learned a valuable lesson about business financing long before he became an entrepreneur. While doing design work for the National Film Board, Hibchen confided to a fellow contract worker that although he loved the work, he was unhappy that the NFB hadn't paid him by the date it had promised.

Hibchen expected a sympathetic ear. Instead, his colleague told him it was his own fault for continuing to come in to work without having been paid. "So, I told the NFB I wouldn't return until they paid me," recalls Hibchen. "They couldn't believe it—but they quickly paid up."

If you lie on the floor, people will walk all over you. Hibchen applied that old saw to the business world upon co-founding Toboggan Design Inc., adopting a no-nonsense policy of suspending work for any client that hasn't paid it within 30 days of being invoiced.

"We're a supplier of design services, not a bank," says Hibchen, president and CEO of Toboggan, a museum-exhibits

designer that ranks 92nd on the 2012 PROFIT 200. "Many business owners feel this policy would damage their relationships with clients. But that's not at all what happens. Clients end up respecting you more."

Toboggan's hard line is just one of several smart ways in which PROFIT 200 companies have met the challenge of finding operational and growth capital. Your own business faces the same challenge, no matter which sector it operates in. And the solutions described here offer you a diverse menu of alternatives to traditional bank financing. (**For ways to work effectively with the banks, see "Bank on This")**

One key lesson is how to stand firm without alienating your clients. Hibchen says it's crucial to do so in a friendly and respectful way: "You don't want to come off as unpleasant or demanding." Instead, Toboggan simply explains to new clients that in return for providing top-notch work, it expects to be paid on time.

Only rarely has the firm had to suspend work. And once initially surprised clients see that Toboggan isn't backing down, they soon pay up. Hibchen says his Montreal based firm has written off less than $1,000 in bad debt since its launch 13 years ago.

Endo Networks Inc. (No. 60) takes a different approach to the critical task of not running out of cash. Peter Day, president of the Oakville, Ont.-based consumer-intercept marketing agency, says his firm adopted its approach to deal with a bitter irony: "Your clients are so happy with what you're providing to them that they give you rapidly increasing deals. Suddenly, you're in a terrible cash-flow crunch that threatens you with going broke."

Endo ran into this challenge when deal sizes for its No. 1 client soared from less than $200,000 to more than $4 million, and grew by at least tenfold for several other customers. His solution was to have a frank discussion with clients about any projects that would put significant cash-flow pressure on his firm. Endo reps politely point out that their firm will need outside financing to cover significant out-of-pocket costs, then will add this financing expense to its invoice—unless client and supplier can find ways together to shrink or eliminate these costs. Often, that entails staggering the delivery schedule, delaying the launch or altering the statement of work.

Endo reps and clients usually find ways to reduce or eliminate the need for outside financing. And the discussions yield another benefit, says Day: "Having an open dialogue about this has strengthened our relationships with clients."

Many PROFIT 200 firms have turned to another option to meet the financing challenge: term loans, although not from a chartered bank. Matthew Horne at DECO Windshield Repair Inc. (No. 21) voices a lament about the chartered banks that's common among entrepreneurs: "The account manager loves us and our business. Then, he turns our loan application over to the credit department and it's always denied."

Horne, whose title at Calgary-based DECO is Captain Orange, says the credit department lumps his business, which runs mobile windshield-repair kiosks, into the auto services and repair category—even though DECO doesn't have the scale or hard assets typical of this category. And the credit reviewers see DECO's zero debt as a negative, because the firm hasn't used debt to grow the business.

A finance major from the University of Calgary who was interning at DECO opened Horne's eyes to an alternative he hadn't considered: the Business Development Bank of Canada. (The BDC has provided financing to 23% of the PROFIT 200.) Horne says the Crown corporation assessed his company more broadly than traditional banks did, including taking into account the owner's character and DECO's increasing gross margins and revenue per employee. "They could see that it was not as if we were struggling, and that clearly we were growing as much as we could afford to," says Horne.

DECO has used the BDC term loan to hire more head-office staff and accelerate its growth. True, the loan costs a point or two more than a chartered bank would charge. But, says Horne, "That 6% or 7% they charge? I'd pay that rate all day long."

The BDC is one of many publicly funded alternatives to traditional bank financing. For instance, fully 45% of the PROFIT 200 use Scientific Research & Experimental Development (SR&ED) tax credits. All told, Ottawa issued $3.6 billion in credits to 21,000 firms in 2011.

Still, the Canada Revenue Agency estimates that 40% of companies eligible for the SR&ED program don't submit a claim. Pierre Savignac, CEO of Emergex SR&ED Consulting (No. 157), a Montreal-based consultancy on government programs for businesses, says sometimes a potential claim is too small to bother applying for. But, he advises, any tax credit of at least $25,000 is worth claiming. Savignac also advises companies to make a claim for eligible research, even if they don't consider themselves high-tech firms.

Other forms of government support also are popular with PROFIT 200 companies, 16% of which have used at least one program. Savignac points to two programs that many thousands of businesses are eligible to apply for but don't. One is the federal economic-development agencies in each region, such as the Atlantic Canada Opportunities Agency. These bodies provide loans to post-startup firms for up to 50% of the eligible cost of infrastructure, equipment and other improvements. The other offering is the Canada Small Business Financing Program, through which Industry Canada guarantees 75% of the cost of loans of up to $500,000 for equipment, real estate, leasehold improvements and other hard assets.

Savignac says that these programs are less onerous to apply for than you may expect, and that the government funding agencies are happy to visit your firm to assess its eligibility.

For many entrepreneurs, the biggest challenge in securing financing is finding someone who truly gets what your business is all about. Christopher Walker solved this challenge in 2005, when his firm, CCL Financial Inc. (No. 31), started buying unpaid debts and collecting from debtors on its own behalf. A decade after this business model had taken off in the U.S., Newmarket, Ont.-based CCL was one of just two such companies in Canada.

When CCL sought bank financing, "We got the 'deer in the headlights' look," says Walker, CCL's president and CEO. "They wondered why we'd want to buy debt that they had already charged off their books."

Fortunately, this business model was already a proven success south of the border—and in a market vast enough to support niche financiers. The U.S., therefore, had private-equity firms with expertise in this sector. "It took a foreign private-equity firm to understand our business model and all the nuances," says Walker.

CCL lined up financing from one such firm, Denver-based KRG Capital Partners. KRG liked the returns so much that rather than cash out from CCL in 2009 as planned, it invested more. This sustained backing has been a key to CCL's rapid growth.

> **"Martin Lamontagne says that many CEOs think their firm's need for financing will go down as their sales grow—"But on the contrary: the more you sell, the more you need financing"**

"Sustained" is a word seldom associated with supplier financing. Most companies tap this source ad hoc, running into a rough patch and then asking a supplier for more time to pay. But Douglas Grosfield, president and CEO of Xylotek Solutions Inc. (No. 142), has taken a different approach to this sort of financing that has given his firm an enduring and major source of capital.

In 2005, Grosfield cofounded Xylotek, a Cambridge, Ont.-based IT reseller and consultancy. He and his partner burst out of the gate by landing an order for $250,000 worth of computer hardware. But they had no money to pay for it and no credit history. "We needed somebody to support us with financing in a way that wouldn't be punitive for interest rates and terms of agreement," says Grosfield, Xylotek's president and CEO.

The partners found this credit by promising Ingram Micro, a giant IT-products wholesaler, that Xylotek would buy exclusively from Ingram in every category it supplies in return for financing this purchase. They also arranged that Ingram would, in effect, own Xylotek's bank account until the latter's client had paid Xylotek. The long background the partners had in the sector helped persuade Ingram to take the risk of extending credit to an upstart. Ultimately, says Grosfield, "They went with their gut, and we seemed trustworthy."

Xylotek and Ingram have since established close personal relationships at multiple levels in both firms, says Grosfield, and "we're very open with our books with their credit department." He says Xylotek's "We only have eyes for Ingram" strategy has paid off for the supplier: "We've rewarded their faith in us with continuing loyalty and increasing deal sizes" that now add up to a few million dollars per year.

"Without that kind of mutual trust and sharing of risk," says Grosfield, "we wouldn't have been able to enter into customer relationships for projects of the scale needed for us to make it onto the PROFIT 200."

Martin Lamontagne advises that whichever financing sources your company uses to fuel its growth, it's crucial to conduct regular reviews of the financing mix and whether you're getting the most out of each source. "A lot of entrepreneurs think their need for financing will go down as they grow," says Lamontagne, president and CEO of Creaform Inc. (No. 175). "But, on the contrary: the more you sell, the more you need financing."

Like many companies, the Lévis, Que.-based developer of 3D scanning technology struggled in its early days to attract capital. "When we founded Creaform in 2002, we were ready to give up a 30% stake for $300,000, but we couldn't find any investors," recalls Lamontagne. Instead, Creaform launched with a $50,000 loan from its local economic-development agency and second mortgages on the co-founders' homes.

By 2004, the firm had attracted a venture- capital (VC) investor. Since then, Creaform has used a long list of funding sources, including two more VCs, SR&ED credits, private investors, customers, bank loans, credit cards and two programs from Quebec's economic-development corporation.

Creaform's management team reviews this complicated financing mix as part of its annual strategic review, considering how much capital the firm will need, where to obtain it and how Creaform can more effectively use existing financing by securing better rates and other terms.

Lamontagne's key advice: ensure that someone in senior management has a strong interest in this area. "We need to have people in our businesses who are passionate about financing," says Lamontagne. "Just as you work every year to improve your business, you should do the same every year for your financing."