ALARM
CAPITAL
ALLIANCE

ALTERNATIVE **FUNDING SOURCES** FOR YOUR BUSINESS

Alternative Funding Sources

Poor financial management is one of the biggest reasons why more than half of small businesses don't survive. This is particularly true in the security alarm business, where the monthly recurring revenue model can complicate matters. Knowing how to manage your business financially is the key to maintaining a sound and efficient alarm business. Whether you're a brand-new security business owner starting a company or a well-established owner, the need for financing may arise. The reasons alarm business owners need to raise capital are no different from other industries—to grow organically, to open a new office, to make an acquisition, to buy out a partner, etc. Therefore, when a company needs additional cash, it's important to know your options.

Outlined are four financing options available to your alarm business.

BANK LOAN

Banks have traditionally been the principal source of outside capital for small businesses. However, obtaining a loan isn't always easy. Before you approach a lender for a loan, you'll want to understand the factors the bank will use to evaluate your application.

There are two types of financing: equity financing and debt financing. When looking for money, you must consider your company's debt-to-equity ratio. This ratio is the relation between dollars you have borrowed and dollars you have invested in your business. The more money you, as the owner, have invested in your business, the easier it is to obtain financing.

Knowing how to manage your business financially is the key to maintaining a sound and efficient alarm business.

If your company has a high ratio of equity to debt, you'd be wiser to seek debt financing. However, if your company has a high proportion of debt to equity, experts advise that you should increase your ownership capital (equity investment) for additional funds. This will prevent you from being over-leveraged to the point of jeopardizing your company's survival.

Equity Financing

Most small or growth-stage businesses use limited equity financing. Equity often comes from investors such as friends, relatives, employees or even customers. The most common source of equity funding comes from venture capitalists. These are institutional risk takers and may be groups of wealthy individuals, government-assisted sources, or major financial institutions. Most specialize in one or a few closely related industries. Remember, venture capitalists are different types of investors when compared to your friends or family. They are there to make a return on investment, and will look to ensure your company is consistently growing and meeting performance targets while turning a profit.

Debt Financing

Debt financing means borrowing money that must be repaid over a period of time, usually with interest. Debt financing can be either short-term, with full repayment due in less than one year, or long-term, with repayment due over a period greater than one year. The lender does not gain an ownership interest in the business, and debt obligations are typically limited to repaying the loan with interest. Loans are most often "secured" by some or all of the assets of the company. In addition, lenders commonly want personal guarantee from the owner—like your house, your building or other, "tangible" collateral—in case of default. This ensures that the borrower has a sufficient personal interest at stake in the business.

A major downside of attempting to get debt financing from a bank is that they often don't consider recurring monthly revenue (RMR) from alarm contracts as an asset that can be collateralized.

Banks also look at your ability to repay the funds you receive. They want to see two sources of repayment—cash flow from the business as well as a secondary source such as collateral. The lender will review your past financial statements to analyze your cash flow.

Generally, banks are more comfortable offering assistance to *businesses that have been in existence for a number of years and already have a proven financial track record.* If the business has consistently made a profit and that profit can cover the payment of additional debt, it is likely that the loan will be approved. If however, the business is a start-up or has been operating marginally and has an opportunity to grow, it is necessary to prepare a thorough loan package with a detailed explanation including how the business will be able to repay the loan. Typically, traditional banks are looking to do large financing transactions...$5 million, $10 million or more. That doesn't really help the small-to-medium-sized alarm company that is looking to grow.

SECURITY-SPECIFIC LENDERS

Another option to consider is a security industry-specific lender. The advantage of talking to an industry-specific lender is that they understand your RMR business model.

The loan officer will already be familiar with the revenue potential, financing and cash-flow needs of the alarm industry, particularly in the context of the broader economy, and can advise with a honed awareness of any obstacles in your business plan.

Loan officers at specialty lenders often have a keen eye for mismanagement and are judicious about loans they issue.

That selectivity is a necessity, as regulators often scrutinize specialty lenders more intensely. One disadvantage of working with a specialty lender is that in the majority of cases, the minimum borrowing amount they will accept is $2MM. Generally, that means you need to have RMR of $75,000 or greater for them to even have a conversation with you. And, if you don't require that much, you may pay fees on money you're not utilizing. Additionally, your interest rate may be higher than if you were using traditional bank lending. If you do find a "boutique" lender that offers loans for less than **$1MM**, the associated fees tend to be much higher due to their creative/nontraditional lending format.

FACTORING DEALER PROGRAMS

Factoring is a transaction in which a business sells its accounts receivable, or invoices, to a third party commercial financial company. This is done so that the business can receive cash more quickly than it would by waiting 30 to 60 days for a customer payment. Factoring is sometimes called "accounts receivable financing."

The terms and nature of factoring can differ among various industries and financial services providers. Most factoring companies will purchase your invoices and advance you money very quickly. The advance rate can range from 80% to as much as 95%, or 24X to 30X average multiple, depending on your business, your customers' credit histories and other elements of your situation. The benefit of factoring is that, instead of waiting for several months for a customer payment, you now have that cash in hand to operate and grow your business.

Factoring is not a loan. No debt is assumed by factoring—you do get your account back after a certain period of time; generally a minimum of three years, depending on the length of the program. The funds are unrestricted, providing a company more flexibility than with a traditional bank loan.

However, factoring is more expensive than a bank loan because of the transactional nature of the process. Costs vary significantly between factors and comparing rates and fees can be challenging. Consequently, invoice factoring cost drivers need to be carefully understood. Factoring may not be a good solution for businesses with seasonality or other significant fluctuations in revenue, because when your business contracts, the cash provided by factoring contracts as well. In addition, factoring companies require that you assign the accounts receivable to them. This means that your customers will be notified to send payments to the factoring company's lockbox. Some businesses are concerned this will affect their customer relationships. It is important to thoroughly understand the terms of a factoring agreement to know if the initial payment terms, costs associated and the end of term agreement work for your business.

TRADITIONAL DEALER PROGRAMS

If you're looking to sell RMR and maximize cash, you will likely want to consider a traditional Dealer Program. **There are a number of different types of dealer programs—each with diverse offerings.** There are manufacturer-sponsored programs that focus on products and channel support. There are programs offered by national installation contractors, and there are third-party monitoring programs that offer support, financial services, acquisition of accounts, branding and marketing efforts, and sales and technical training, among other advantages.

Many owners find participation in a dealer program a vital part of their overall business strategy.

A partnership works best when an owner fully understands how each program works and the individual requirements. Too often an owner only looks for the "highest multiple and the quickest turnaround," but owners need to ask a lot of other questions in order to make sure it's the right thing to help them accomplish their goals.

Owners often may be so focused on getting money that they ignore what's involved in the process either after the fact or on an ongoing basis.

When it comes to dealer programs, one of the biggest pitfalls is that owners believe they have to lose their brand identity when they join a dealer program. They don't realize there are programs (like ACA's) that allow you to keep your brand while enjoying the benefits of the support offered through the program. Members are empowered to leverage the relationships and resources of the programs in order to build the client base they might not otherwise have been able to acquire.

Another area where some dealers need to pay attention is in business education. While some dealer programs offer a great deal of business education opportunities, such as webinars, others may not provide such opportunities.

Accomplishing a successful dealer program partnership can be a win-win situation, but you need to know the options. For example, if you are ready to take on the next challenge in your life and would like to sell your alarm company outright,

look for a company with acquisition experts to ensure the process is simple, the relationship is transparent, and the agreement is equitable. They should understand that you've worked hard to grow your business, and you are assured that your customers will be managed and supported with the integrity, superior service, and customer focus that you worked so hard to deliver.

If you aren't quite ready to sell your entire business, but you need additional working capital or have plans to open in a new market; you want to look for a buyer that offers partial security account acquisitions which gives you the freedom to sell alarm accounts in smaller quantities. Just make sure you are able to continue providing service after the sale to realize revenues on each service call.

Look for a dealer program that sets multiple structures on various monitoring packages—to take the guess work out of what will be paid for each contract sold. You'll want to look for bundled pricing on alarm monitoring services and broad equipment options. If you are able to continue to service the accounts you sell, you realize revenue, as well as capture all leads and referrals, while continuing to establish your company's brand.

Just as alarm business owners and integrators will need to do their homework, you can expect vendors and service providers — especially those operating purchase programs — will also do their homework when evaluating potential members.

Managerial expertise is a critical element they will check. In fact, poor management is one of the most frequently cited reasons alarm businesses fail. Companies who offer dealer programs are going to be looking at the longevity, health and credit worthiness of your business, so make sure you have taken the steps to prepare your company before you consider any type of sale.

Regardless of the financing option you choose, look for a relationship that meets your financial needs and where you'll get the customized, superior service that will allow you to reach your business goals. **In other words, find a partner you can trust for the long run.**