How positive debt can help SA's SMEs grow

By Trevor Gosling

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Regardless of the size of your company or how great your product may be, at some point every business will need more finance than they have immediately available. When this happens, accessing additional funding will help to give your company the fuel it needs to grow.

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It may seem counterintuitive, but fast access to capital plays an important part of any business growth strategy.

There is often a misconception that all debt is bad or that it is only used by struggling companies.

In fact, the opposite is often the reason why some of the world's largest companies, including the likes of Apple and Coca-Cola, routinely seek capital infusions to keep profits within the company, maximize their tax savings, and assist with short-term financial obligations.

When raising funds, selecting the right type of business financing plays a very important role in determining how a business accesses capital and long-term profits.

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Debt makes expansion possible

For business owners, debt can also help to improve the bottom line of a company because it makes expansion possible, and can enable increased marketing efforts or the purchasing of new equipment and products.

Loans can also support seasonally driven companies that are often extremely profitable during peak season trading but need the extra cash to buy inventory and supplies during the quieter months. This is where debt can help to bridge the gap and balance out uneven cash flows throughout the year.

Generally, the two most common ways in which this is done is through selling equity of the business or with debt financing.

For many of South Africa’s burgeoning SMEs, what matters most is the overall cost of business funding and the speed at which it can be acquired. While both financing options can help to give access to capital, using debt to support growth rather than equity is generally preferred.

While you will owe interest on debt, unlike equity, the funding that it provides doesn’t mean you will have to lose a stake in your business. Any profits that are made after paying debt and interest will be yours to keep. It is also now possible to acquire a business loan in as little as 24 hours.

Additionally, if you choose to take on a partner to increase capital, it will also mean that you lose full control of your business and be asked to share profits made going forward – which for many fast-growing start-ups is not always the most attractive option.

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Managing cash flow

While loans are a great tool to finance inventory or equipment purchases, an increasingly popular debt instrument is a business line of credit, or credit facility. A credit facility is one of the best ways to manage cash flow – especially if a business needs immediate access to funds to cover short-term expenses while waiting for customer payments.

If you are responsible with your debt by making on-time payments, this can also help to improve a business’ creditworthiness. In turn, these smart credit habits can help to increase your overall spending limit, lower future costs, and help you to obtain better terms for future loans.

The critical step that business owners need to consider before taking on any form of debt is to ensure that they have a plan on how to use any additional funding to generate a return and improve profits.

If you don’t have a plan, or if you feel that you’re the company is struggling financially, taking on debt for the wrong reasons can cripple your business.

It is not just about your bottom line. If done correctly, responsible debt can grow your company and give it the strategic advantage needed for a profitable future.

ABOUT THE AUTHOR

Trevor Gosling is co-founder and CEO of Lulalend, an online provider of short-term business funding.