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A Closer Look At Businesses Part II

By L. Carlos Lara

A Business Credit survey[1] conducted and published in March 2016 by the Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond, and St. Louis reports that "*cash flow*" is the number one problem facing small businesses with fewer than 500 employees. At the same time a *Financial Stability Report* dated November 2018 by the Board of Governors of the Federal Reserve cites that business-sector debt relative to GDP is historically high and "*debt has been growing fastest at firms with weaker earnings and higher leverage.*"[2] In essence this report insinuates that the very same cash flow difficulty also exists among the larger companies, that is, those businesses with more than 500 employees.

The solution for this cash flow dilemma is of course adequate *financing* of the type that can be accessed when needed and in sufficient amounts to help smooth out the ups and downs of cash flow irregularities. But since financing entails the taking on of debt it is here that we see how small businesses and large businesses differ with the main contrast between the two being their choice of financing options. We will look closer at some of these options in this article but will also drive home the point that I have always maintained, which is that *cash flow management* is by far the most important activity in any business regardless of size.

RISK CAPITAL

If you will recall in *Part I* [republished in December 2023 *BankNotes*] of this article, we came face to face with the fact that entrepreneurship is not necessarily for everyone for the simple reason that approximately half of business startups fail within the first five years in operation. A large percentage of those businesses fail in the second year, so the odds for entrepreneurial success are not that promising. And, since business failure is associated with financial losses considerable time should be spent examining the potential profits versus the startup costs of the new business idea prior to launching it. The first and foremost consideration is to realize that whatever amount of *risk capital* will be used to set the new venture in motion it

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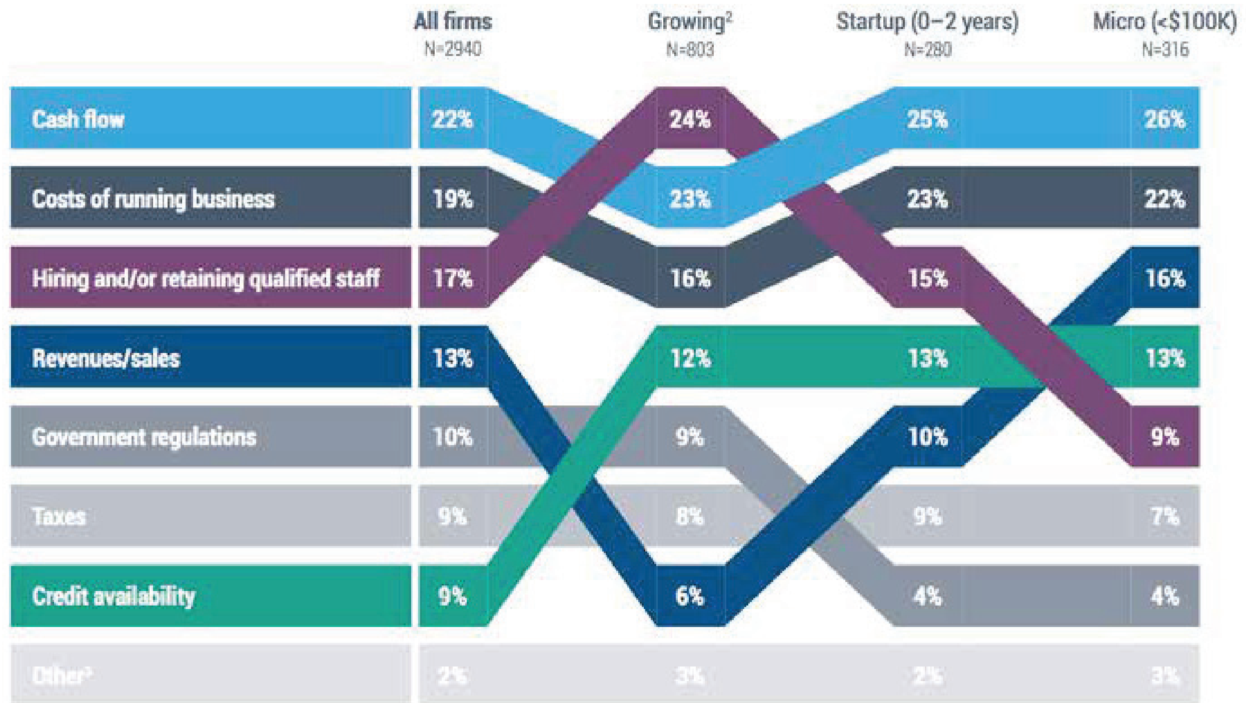


Chart A Source: 2015 Small Business Credit Summary-Report On Employer Firms, Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond and St. Louis, March 2016

will immediately require cash flow management the minute it's put to work in the new enterprise and will continue *ad infinitum*.

To get an idea of what's in store for the new entrepreneur going into business for the very first time, recall your own first-time childhood experience of attempting to ride a bicycle with only two wheels. Once you pushed off you had to keep peddling to keep the bike rolling and we all remember that it was not easy to do. The good part about that exercise was that we could fall and try again as many times as we wanted. Eventually, it was a combination of momentum, agility, balance, and what we might call *skill* that kept the bicycle upright and moving. In a sense cash flow management is somewhat similar to that experience except you are not allowed to fall. Business ownership requires continuous peddling (cash flow management) while steering the enterprise forward with absolutely no guarantee of success.

But besides these management skills an entrepreneur must also know how to sell (market) its products (or services) effectively because *sales* (fees, revenues, margins, or commissions) must continually pour into the enterprise to cover outgoing expenses or the business will not make it. When cash flow problems surface, as they are sure to do, *a loan or a line of credit* can come in mighty handy to either help with cash flow volatility, rescue the business from demise, or assist it in growing it and expanding it even further.

It is for these reasons that businesses very early on in their life cycle and also as they mature will seek out lenders that can provide the much-needed additional capital. What businesses soon discover is that credit is readily available in the marketplace provided the business can meet the lender's credit requirements in order to qualify for it. It is this credit qualification process that can become a huge stumbling block for many businesses. It is both difficult (time consuming) and intimidating, especially for new

businesses, because it involves putting up collateral and providing personal/business guarantees. This is one of the main points we stressed in our latest book, *The Case for IBC*, co-authored with Nelson Nash.

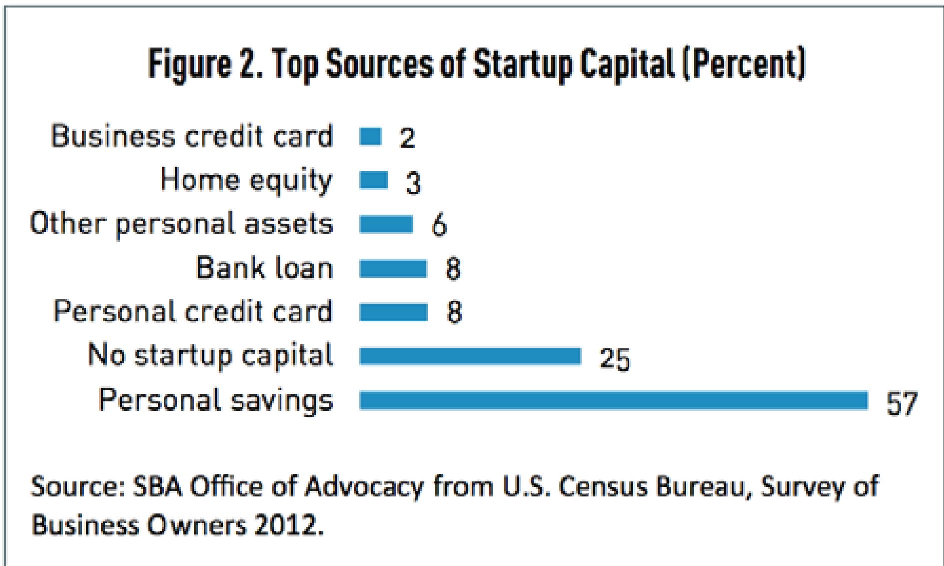
SEPARATING LARGE BUSINESSES FROM SMALL BUSINESSES

To probe further into the nature of financing options we need to properly divide the entire U.S. business sector in terms of size. A business with over 500 employees is considered a large business and there are only 18,600 such firms in the U.S. and approximately 5,000 of them are publicly traded companies. Alternatively, there are 5.8 million small businesses that have at least one employee, but fewer than 500 employees. So, some of these businesses, while considered small, can be rather large enterprises. Interestingly, the remaining 23 million small businesses in the U.S. have no employees at all and are referred to as "*nonemployer*" firms. Obviously, the financing needs of each of these groups will vary significantly especially for a startup company or a nonemployer firm whose initial capitalization needs will be much smaller and financing options much more limited.

As a case in point, according to the *Small Business Office of Advocacy*[3] the primary source of startup capital to start a business comes from personal savings and second to that is actually "*no startup capital*" at all, which can only mean a business that is launched by strictly generating sales in order to fund its operations. After that option the next best source of capital for startups, believe it or not, are *personal* credit cards.

When it comes to "*expansion capital*" for an operating going concern (not a startup) the primary source of capital is, once again, personal savings. *Chart B*, however, shows that after personal savings the next major source of capital for expansions are from *business profits*. That's because most business owners view their business as their main investment and therefore tend to re-invest all their profits back into their business.

Another 2016 report released by the SBA entitled *Frequently Asked Questions About Small Business*



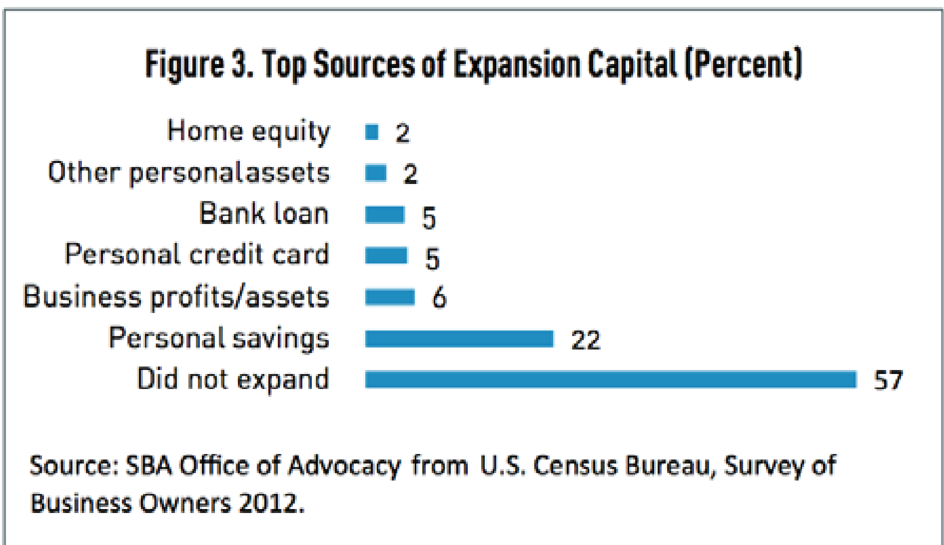


Chart B Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012. Released July 2016

Table 1. Amount of Capital Needed to Start a Business (Percent of Firms)

	Firms with Employees	Nonemployer firms
Less than $5,000	22.5	39.5
$10,000 to $24,999	14.2	7.1
$50,000 to $99,999	11.5	2.8
$250,000 to $999,999	7.3	1.8

Note: Figures recalculated to account for "don't know" responses. Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012.

Chart C Source: SBA Office of Advocacy from U.S. Census Bureau, Survey of Business Owners 2012. Released July 2016

Finance[4] says that the amount of actual capital needed to start a small business can be less than $5,000, which is surprising yet quite encouraging. In fact, 22.5 percent of the nation's small employer enterprises are recorded as having done exactly that. Only 7.3 percent of the 5.8 million small employer businesses required between $250,000 and up to $1 million to get their businesses up and running.

NON-TRADITIONAL FORMS OF FINANCING

In addition to traditional lending sources such as *banks, home equity loans*, and *personal credit cards*, there are a variety of other non-traditional financing options small employer businesses can and do use. For example, there is *leasing, trade credit, equity investment* (exchanging a portion of ownership of the business in return for capital), *factoring*, and more recently, *online lending platforms*, which is one of the newest and fastest growing non-traditional lending sources today.

According to a special report entitled, *Opportunities and Challenges in Online Marketplace Lending*, issued in May 2016 by the *U.S. Department of the Treasury*[5] it predicts that loan origination volumes for these types of online lending sources could reach $90 billion by 2020 especially as small businesses increasingly turn to these online marketplace lenders as financing sources in the same way the general consumer market has done.

Online marketplace lenders have become formidable challengers to their traditional lending competitors because they can make a funding decision in 48 to 72 hours. They can also make small loans with short maturities with daily remittances processed immediately by direct withdrawals from the borrower's bank account. In other words, they provide immediate cash flow relief in exchange for repayment terms that tap directly into the client's business flow of money. Since online lenders have no branch offices there is never a face-to-face interaction, which gets rid of the intimidation factor and everything else, from credit checks to actual funding, is all automated and online.

The online lending sector has developed two primary business models, the "*direct lenders*," which originate loans to hold in their own portfolios. Then there is the "*platform lenders*," which generally partner with a depository institution (a bank) to originate the loans, but afterwards the online lender will sell the loan obligation to investors. This provides for various management fees for the different investment partners in addition to the interest payments on the loan, all at the expense of the borrower. In other words, the cost of capital when using online lending is not cheap.

The recent entry of online lenders into the securitization market and the strong interest from institutional investors, venture capital firms, and hedge funds has also increased the concept's investor

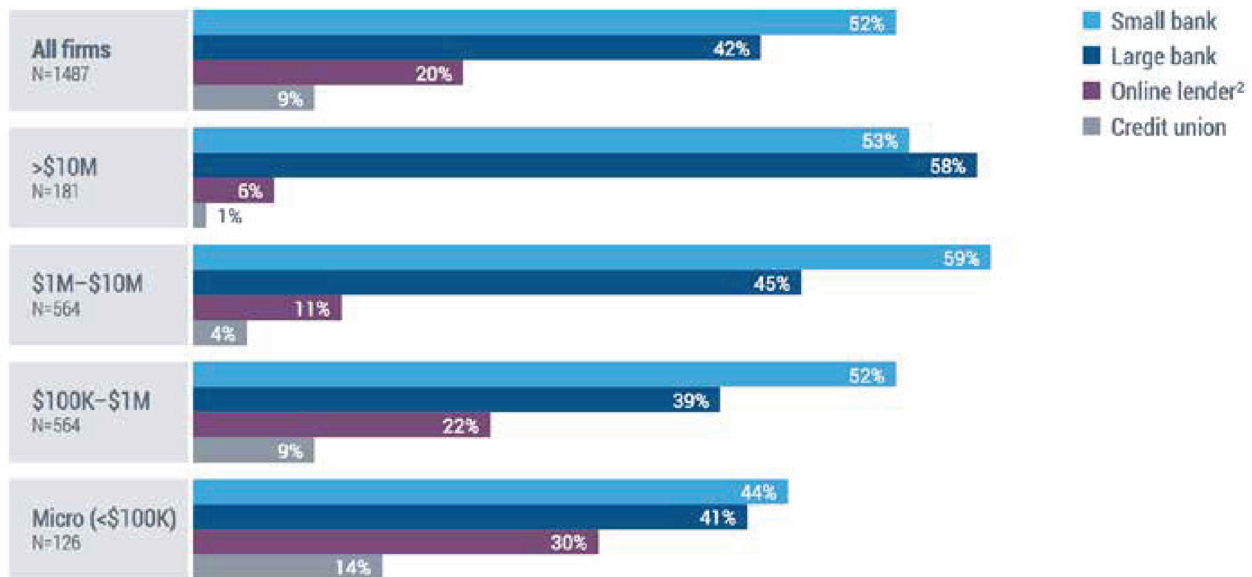


Chart D Source: 2015 Small Business Credit Summary-Report On Employer Firms, Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond and St. Louis, March 2016

base that is providing the necessary monetary fuel for online lenders to continue to expand in their markets.

Looking at this from an Austrian perspective the Fed's low interest rate environment coupled with the strong demand from cash strapped consumers and businesses after the 2008 financial crisis has been a significant contributing catalyst to this idea's growth. Plus, investors starved for income yield have also provided growth synergy and together all of it has given rise to what now appears as a very successful new financing source in the marketplace.

Then again, it could be nothing more than another huge malinvestment, (a bubble) caused by the Fed's cheap money policy. We have to keep in mind that this is still a very new credit source that is totally untested in a credit cycle downturn having just barely entered the lending field in 2006.

Notice that Chart E indicates that successful loan applicants' reasons for dissatisfaction from online lenders were three-fold: *lack of transparency, unfavorable repayment terms and high fees and interest rates—"rates that can go up to 45% for a four month institutionally backed loan*," according to the SBA Office of Advocacy. As interest rates continue to rise this lending source could be impacted very negatively. We will need to keep close watch and see.

Finally, we should not leave this section on non-traditional forms of financing with- out mentioning the *Infinite Banking Concept (IBC)*, which is a concept that makes use of a specially designed life insurance contract as a means of providing borrowers with necessary capital with superior flexibility with regards to its repayment terms. Since it is derived from the insurance sector and not from commercial banking and Wall Street its very conservative multi-dimensional benefits are incomparable.

As to whether it can survive a credit cycle downturn

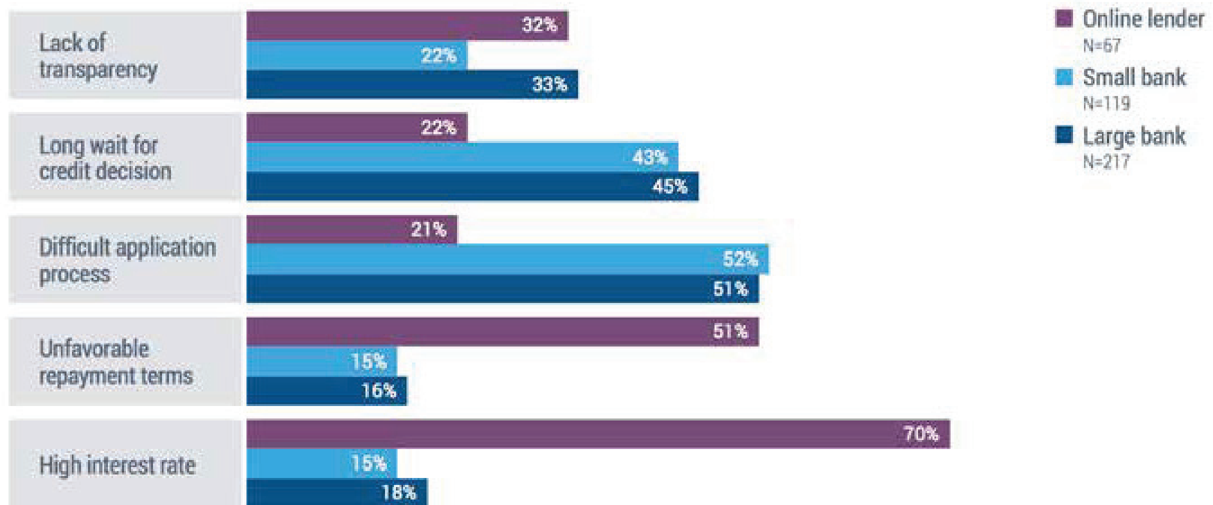


Chart E Source: 2015 Small Business Credit Summary-Report On Employer Firms, Federal Reserve Banks of New York, Atlanta, Boston, Cleveland, Philadelphia, Richmond and St. Louis, March 2016

like the 2008 financial crisis—in other words, is it tried and tested? The answer is yes, and it even survived the Great Depression of the 1930s! Although understanding its unique characteristics and benefits takes a rather bold shift in thinking it is a financing system Bob and I fully endorse. It's ideal for business startups but works well for the larger more established businesses too. To learn more about IBC the ***LMR*** continuously provides numerous articles about the concept, but make sure you also read the original source book, *Becoming Your Own Banker* by R. Nelson Nash and his latest book released in February of this year (2018), *The Case for IBC*, co-authored with Bob and me.

You can obtain a copy of Becoming Your Own Banker here: https://infinitebanking.org/product/becoming-your-own-banker/

The Case for IBC here: https://infinitebanking.org/product/the-case-for-ibc-2/

IPOS, ANGEL MONEY, VENTURE CAPITAL, PRIVATE EQUITY, DEBT FINANCING

According to the latest published data *(2016 SBA Office of Advocacy)*[6] "angel" capital financing for small employer businesses remains a relatively small part of capital sources making up less than 2% of the market where the average angel investment is only $330,000 as of 2016. Angels are wealthy investors who are quite often entrepreneurs themselves and are also known as "accredited" investors because they are individuals that can substantiate their net worth and income according to SEC requirements. Angels provide capital and or credit support for businesses by investing individually or as a group where they generally take an equity position in return for their investment.

Venture capital, on the other hand, is sourced from investment firms that specialize in providing substantial blocks of capital for emerging companies

seeking funds for the first time. This differs from *private equity* firms who specialize in funding much larger and more established businesses seeking "*additional*" capital infusions or looking to sell a large portion of the established business. But in either case both types of investor firms, equity and venture capital, will exit the company after they make their initial investment and once they have spearheaded a merger, or an acquisition. Initial public offerings (IPOs) have become less popular in recent years simply because they are too expensive to underwrite and register, plus the ongoing regulation makes the entire process extremely burdensome.

Larger businesses that have a long-standing operating track record and profitability history are choosing to issue their own bonds in order to raise additional capital. As I pointed out in my recent article, "The Wealth Effect," in the November 2023 issue of the ***BankNotes***, borrowing by major U.S. corporations has grown exponentially since the 2008 financial crises fueled principally by the Fed's prolonged low interest rate environment. What we have seen large businesses do in recent years is use the cash derived from the sale of their own bonds to purchase their own stock while others have used the cash to buy out their competitors. But the problem is that many of these corporate acquisitions are now overly leveraged as the recent 2018 Board of Governor's *Financial Stability Report* pointed out. The concern is that a downturn in the economy could lead to a surge of downgrades for these bonds into junk rating causing weaker companies that have issued them to lose access to capital and spiral into bankruptcy. Once again, the Fed's tightening could have a dramatic effect in this corporate bond arena and is an area that also warrants careful scrutiny.

CONCLUSION

I began this two-part series on businesses by first of all simply answering the question, "*What is a business?*" My sole intent was to take a much closer in-depth look at some of the most important essentials of business ownership by first beginning with the entrepreneur and his idea in light of the failure rate that takes place with new startups within the first five years in operation.

What I have attempted to do in this second part of the article is provide the reader a more amplified view of businesses in the U.S. economy by focusing primarily on their essential activity, which is cash flow management and also by examining their access to capital (the lifeblood of a business) in the various financing sources available to them in the marketplace depending on their size and maturity.

What I have hopefully been able to impress upon you is that at the higher echelons of government surveillance as recent as November 2018 cash flow was determined to be a significant problem for both small and large businesses, which implies that on a grander scale in the whole of the economy there is a seemingly "*robbing Peter to pay Paul*" scenario building up driving up excessive borrowing on top of already overly leveraged companies. There is a concern that credit markets could seize up abruptly especially as interest rates rise and asset prices continue to fall.

Even so, the need for credit and immediate access to that credit will only increase in demand all the more if what we are seeing is correct and we think we are. More the reason why you must seriously consider without delay implementing your own form of *privatized banking*—the ultimate cash flow system, which is *Nelson Nash's Infinite Banking Concept (IBC)*.

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Take control of your financial world by
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The following financial professionals joined or renewed their membership to our ***Authorized Infinite Banking Concepts Practitioners*** team this month:

New Members

- Marc Lalonde, Gatineau, Quebec
- Claudia Caruso, Laval, Quebec
- Jonah Dew, Greenville, South Carolina

Membership Renewals

- Henry Wong, Markham, Ontario
- Chuntae Nicole, Philadelphia, Pennsylvania
- W. Henry Mora, Houston & Lubbock, Texas
- Kyle Fuller, Mesa, Arizona
- John Urbik, Tyrone, Georgia
- Mark Clarke, Camp Hill, Pennsylvania
- Steven La Bella, Fontana, California
- Jim King, Cody, Wyoming
- John Montoya, Dublin, California
- NIck Kosko, Louisville, Kentucky
- John Ward, Salem, New Hampshire
- Kyle Mans, Red Cloud, Nebraska
- Michael Burrill, Youngsville, North Carolina
- John Perrings, Oakland, California
- Cheryl George, Atlanta, Georgia
- Robert Burnett, Estero, Florida
- Karen Powell, Atlanta, Georgia
- Will Moran, Edmonton, Alberta
- Brandon Goswick, Marshall, Texas
- Leandro Fernandez, Phoenix, Arizona
- Dale Moffitt, Red Deer, Alberta
- Todd Gregory, Springfield, Missouri
- Dave Swanson, Wheaton, Illinois

Before you look for a practitioner, we suggest listening to the following two episodes of ***The Lara Murphy Report.***

How-To Guide for Starting IBC, Part 1 How to begin your study of Infinite Banking, including finding an Authorized Practitioner.

How-To Guide for Starting IBC, Part 2 How to prepare for your first meeting with an Infinite Banking Authorized Practitioner.

You can view the entire practitioner listing on our website using the Practitioner Finder.

IBC Practitioner's have completed the *IBC Practitioner's Program* and have passed the program exam to ensure that they possess a solid foundation in the theory and implementation of IBC, as well as an understanding of Austrian economics and its unique insights into our monetary and banking institutions.

The *IBC Practitioner* has a broad base of knowledge to ensure a minimal level of competency in all of the areas a financial professional needs, in order to adequately discuss IBC with his or her clients.

This online **video series** for the general public provides a comprehensive introduction to the *Infinite Banking Concept.*

The first four modules are free, you can view them here:
infinitebanking.org/foundations
The remaining eight modules are subscription-based, costing $49.95 for all eight.

*Or contact an **Authorized IBC Practitioner** and ask for a coupon code that will enable you to watch all twelve modules FREE.*

Module 1: Introduction to the Nelson Nash Institute

Module 2: What the Infinite Banking Concept Is

Module 3, Part 1: How IBC Works

Module 3, Part 2: Policy Loans & The Nature of Collateral

Module 3, Part 3: How to Read a Policy Illustration

Module 4: Why Nelson Calls It The Infinite Banking Concept

Module 5: The Life Insurance Industry

Module 6: Why Not Buy Term and Invest the Difference?

Module 7: Using IBC to Pass Wealth to Future Generations

Module 8: The MEC Rule and Policy Design

Module 9: Does IBC Work for Older People?

Module 10, Part 1: IBC for the Business Owner

Module 10, Part 2: IBC for the Business Owner

Module 11, Part 1: Using Your IBC Policy: Premiums, Dividends, and Policy Loans

Module 11, Part 2: Using Your IBC Policy: Premiums, Dividends, and Policy Loans

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