Manufacturing Finance 101

Options, the Process & How ERP Helps

xTuple

Disclaimer

Manufacturing Finance 101 is for the sole purpose of providing an introductory level understanding of common methods, terms, documents and tools used in the financing process as it relates to manufacturing companies.

While the team at xTuple has experience working with manufacturing companies securing financing, we are not and do not pretend to be financial advisors. Our knowledge and understanding is based on our collective experiences and shared knowledge. There are many resources available to companies seeking financing; we recommend consulting professional advisors such as attorneys, accountants and representatives from the financial institutions with which you work to learn more.

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Introduction

xTuple is not a consulting company or an investment banker.[1] We don't help manufacturers find or raise money for operations; we provide a robust industry-centric enterprise resource planning (ERP) software solution. **So why provide information on the basics of finance for manufacturers?** Because xTuple is committed to doing whatever it takes to help keep the supply chain moving no matter what is going on in the world. Additionally, the strength of our management team rests in their diverse backgrounds, which encompasses manufacturing and growth consulting. This uniquely positions us to help manufacturers understand financing. So, the real question is: *why wouldn't we* provide a guide that might help our customers and others in the industry?

The purpose of *Manufacturing Finance 101* is to outline some of the key types of funding available to manufacturers and provide a baseline resource and considerations when planning for growth.

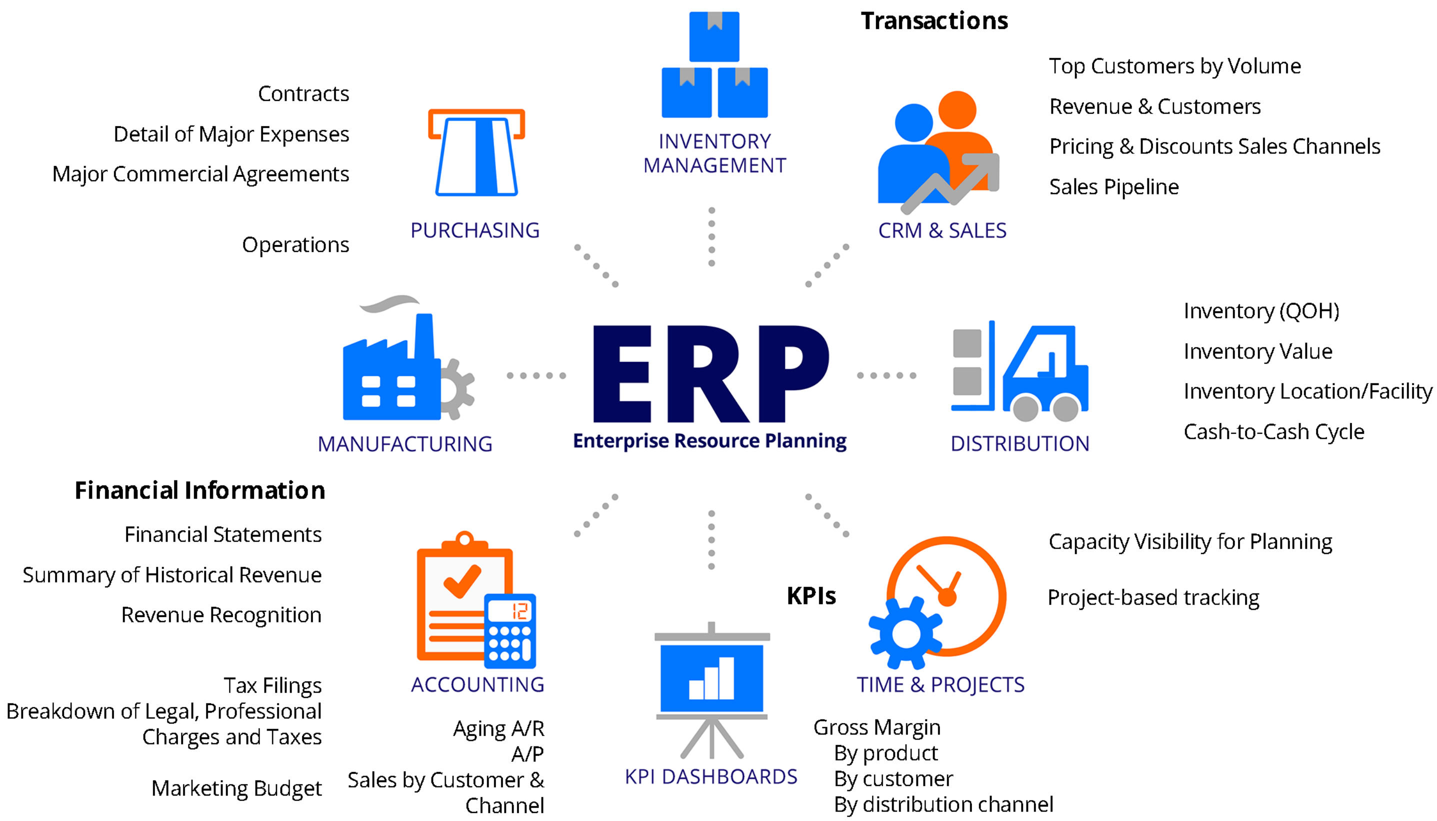
No one goes into business to break even. (We apologize for the first of many *buy low, sell high statements*.) Achieving profitability requires the ability to measure, evaluate, adjust and repeat until you're maximizing production and performance for sustainable profitability. Growth beyond that requires additional investment; investment from company profits, ownership or external sources. Infusing capital from outside investment can help a company grow profits more quickly — increasing the value of the company.

What does all of this have to do with ERP? *Everything.*

Whether through investment or financing, securing capital to stabilize and/or grow begins and ends with a comprehensive due diligence process. The availability and accuracy of information can be the difference between success and failure — not only in getting financing but for your business in general.

The right ERP puts accurate inventory, sales and financial information at your fingertips, giving you the ability to quickly and easily provide current and historical information that can be verified by financing sources.

[1] Manufacturing Finance 101 is intended to provide an overview of the financial landscape as it may relate to the manufacturing industry. It is not the intention of the author, contributors or company to provide a comprehensive, academic or consultative recommendation of when or how to secure financing. The sole intention of Manufacturing Finance 101 is to provide a guide to definitions and considerations.



Financing, Funding, Investing & Investors

Before we dive in, let's clear up some terminology. While both financing and investing serve the purpose of bringing money into a company above and beyond sales revenue, these are very different activities. While the types of financing will be broken down in greater detail in the section *Types of Financing*, for the purpose of clarity and accuracy, let's define *financing* and *investing*.

Financing describes the efforts of a company to get money through borrowing, earnings or investment from outside sources such as investor funding. *Investing* is when a company gets money by building up operations or purchases investment products (stocks, bonds, annuities, etc.). The information in this eBook is focused on some of the most common types of financing available to manufactures, the process for obtaining financing and some considerations that can be helpful. The ultimate goal is to provide a guide that puts the process into context and simple terms with as little use as possible of complicated industry terms.

Reasons to Secure Financing

At the beginning of a company's existence it typically requires startup financing — the capital it needs to begin operating. This may come from a parent company, its owners, a bank or group of investors who in exchange for capital, are granted *equity* in the company. Whether in its first few years or well into maturity, a company will — at different times and for any combination of reasons — require additional capital. Even Apple.

While the details behind the need for additional capital are specific to and vary by company and industry, the following are overarching categories of needs for operational companies. The following are not mutually exclusive and are strictly meant to provide the foundation for understanding the reasons an established company might require additional financing — either in the short or long term.

- **Working Capital**
- **Asset Purchase**
- **Growth**
- **Turnaround/Debt Restructure**

For each of these types of financing, we'll provide a brief description and business use case, followed by specific examples.

In 1977, while still operating from a Silicon Valley garage, Steve Wozniak and Steve Jobs sought investment — receiving $250,000 from an Angel Investor. Before going public in December of 1980, the company had three additional rounds of funding from Venture Capitalists estimated at between $3.5 and $7 MM.

Even a company that today is estimated to be worth $1.3 Trillion needed help to get moving.

Working Capital

Working capital, *aka net working capital is the difference between a company's assets and its current liabilities*. Or simply put, working capital is the difference between cash, accounts receivable (A/R), inventory (raw materials and finished goods), and accounts payable (short-term debt obligations). In more common terms, working capital is what a company needs and uses for day-to-day operations.

The need for additional working capital may be as simple as wanting to capitalize on supplier discounts to buy in bulk, hire temporary/seasonal employees or to compensate for shortfalls in sales or delayed payments from customers.

Types of financing that can be used for working capital include traditional and alternative debt financing, such as:

- **Term Loans**
- **Lines of Credit**
- **Business Credit Card**[2]
- **Inventory Financing**
- **Vendor Credit**

> "Long-range planning does not deal with future decisions, but with the future of present decisions."
>
> **– Peter Drucker**

Asset Purchase

In manufacturing, a facility and equipment are two key assets manufacturers live and die by. Increasing usable space can in turn increase capacity and directly impact revenue; upgrading or replacing equipment can improve production and impact everything from output to quality. Whether a company needs one or a fleet of vehicles, new or new-to-them equipment for their operation, purchasing assets that directly impact efficiencies and production is key to growth.

Often companies may have enough money to cover smaller purchases or manage day-to-day operations, but making a major asset purchase — also known as a capital expense or CapEx — will put too a great of a financial stress on the company. In those instances a company will make the decision to secure additional funding — usually alternative types of debt that is use-specific. Naturally if the asset is real estate or a facility, a longer-term loan would be in order.

Types of use-specific asset purchase options include:

- **Invoice Financing**
- **Lease Financing**
- **Purchase Order Financing**

[2] The most beneficial cards will provide some manner of reward, favorable terms and discounts for paying early.

Growth Financing

Growing to the next level takes capital. Expansive growth requires capital to fund everything from larger purchase orders to acquiring a competitor. That said, financing growth involves the use of debt, equity and/or hybrid financing methods to achieve expansion/growth in the most cost-effective (and sometimes fastest) manner. The first order of focus when looking to finance growth should be defining the strategy and tactical execution plan of achieving growth — in other words, understanding exactly how the company plans to achieve growth and related goals will help determine the exact resources necessary (money, people, space, etc.). Only then can the best financing solution for the company be identified.

In addition to cash from a company's operation, asset liquidation and cash from cost reductions, two typical financing options for growth financing are:

- **Long-term Loans**
- **Investor Financing**

Turnaround

Just like it sounds, sometimes a company needs to turn things around to become profitable or get the business back on track. When a company is emerging from a period of poor performance or is planning to make changes to do so, this is referred to as a *turnaround*.

The cost of turning a company around can include everything from equipment to key hires; usually key senior members of management are replaced. Executive replacements are instrumental in executing turnaround strategies.

Investor financing in a turnaround can be valuable beyond an infusion of cash. An investor or group with experience in turnarounds in a specific industry or with a specific business model can provide resources beyond money — such as introductions to key organizations along the supply chain, or they might bring a network of prospective customers.

Typical options here are also:

- **Long-term Loans**
- **Investor Financing**

Debt Restructure

Established companies may be carrying old, high-interest loans or might be on the brink of default, or worse bankruptcy. Even when working with creditors a manufacturer might be unable to free up the capital necessary to continue operations. Rather than give up, there are viable options — consolidation or investment, such as a debt-for-equity swap, where in exchange for equity in a company, the investor assumes the debt. In short, debt restructuring is when a company is at risk of defaulting on existing debt and looking for better interest rates by refinancing existing debt.

Don't confuse debt restructure with debt consolidation. Debt restructuring is refinancing; debt consolidation is borrowing to turn existing debt into a single loan. In debt restructuring, existing loans, rates, and other terms are renegotiated.

Avoiding Pitfalls

Whatever the reasoning behind the need for financing, it is key to understand the exact need and make sure the best type of financing is identified. It is important not to confuse short-term working capital needs with long-term permanent requirements, such as the need for seasonal labor and a key[3] piece of equipment. Another example is not tying up working capital — the cash needed to purchase raw materials for production or supplies — on long-term expense, such as hiring a permanent employee, real estate or equipment. When introducing company credit cards, strict guidelines for their use are key to managing expenses.

In the next section, *Types of Financing*, we provide insight into common debt and equity financing instruments.

Use of Proceeds

Any lender or investor will obviously require a detail of how funds will be used, so understanding the exact needs of the company is necessary. A simple statement that outlines how the money will be used, is usually included in a business plan, prospectus (in the event of an initial public offering, or going public) or executive summary when pursuing private equity.[4]

XYZ Company
Use of Proceeds Statement

Net Proceeds	**$ 1,750,000**
Equipment & Machinery	$ 650,000
Marketing & Sales	$ 750,000
Salaries	$ 350,000
	$ 1,750,000

[3] Traditional financing refers to standard loans, credit cards, lines of credit, etc. that can be secured through a commercial bank. Alternative financing refers to funding coming from other sources such as private finance companies, for example, asset-based lenders.
[4] Equity financing involves seeking financing from investors either in a public forum – see IPO and OT in the Glossary section — or private forum. In both, financing is provided for equity stake of the company — see shares and stocks in the Glossary section.

The following are examples of the most common uses of proceeds.

Expansion

Expansion is when a company reaches the point where it must expand operationally to grow revenues (and profits). In manufacturing, this could mean adding another shift for increased production to meet growing demand, which means more employees. It could also mean adding a second facility to serve customers from a regional center. There are many ways a business can expand, the following highlights the most common.

- **Adding sales employees**
- **Increasing marketing efforts**
- **Adding products or services**
- **Acquiring a competitor or supplier**
- **Adding online sales**

For example, a manufacturer that sells directly to retail outlets for business-to-business-to-consumer (B2BC) sales may decide to sell discontinued, returned or excess finished goods directly to other businesses or consumers via Amazon. Creating the infrastructure to successfully launch a program will require an investment in technology, specialized team members, packaging, etc.

New Products

Strategically expanding product lines or introducing new products requires investment from research and development (R&D) to production to product launch. From hiring to equipment to advertising, new products are just one of the ways a company can expand into new markets or increase product availability to better meet demand within existing markets. The following outlines areas financing may be used:

- **Research & Development**
- **Production & Packaging**
- **Marketing & Sales**
- **Logistics & Fulfillment**

Strategic Hires

Whether rebuilding your management team or adding highly specialized employees, such as ecommerce experts, product development pros or a COO with deep roots in ISO, the cost of recruiting and hiring the right person may constitute an expense(s) that requires financing.

Whether considering debt or equity, any financing that is not strictly use-specific, may be used for strategic hires. The type of financing obtained, and subsequent legal documents will detail permissible use of funds and should be in line with your use of proceeds.

CapEx

Capital expenses are related to physical assets — trucks, real estate, facilities, technology or equipment. CapEx is often associated with new projects or investments by the company — these can include making capital expenses to repair or expand a facility, purchase a major piece of equipment such as like a new or used forklift. In short, the expense is categorized as "capital" and is reflected in the balance sheet as an investment rather than on the income statement as an expense.[5]

Types of CapEx include:

- **Facilities — new or major repair/ maintenance**
- **Real Estate**
- **Vehicles**
- **Technology**
- **Major machinery**

[5] Operating expenses (OPEX) are related to the day-to-day running of the business and are detailed in the Income Statement as expenses. Capital Expenses, or CapEx, are reflected in the Balance Sheet as an investment because the company will incur a benefit in the future as a result of the purchase/expense.

“Many of life’s failures are people who did not realize how close they were to success when they gave up.”

— Thomas Edison, Inventor

Risks & Considerations

The following are common pitfalls to avoid, considerations and some of the general risks we suggest be kept at the forefront of your mind when considering any type of financing. Consulting a certified financial advisor is always a good idea. We hope *Manufacturing Financing 101* helps put manufacturers considering financing a little ahead of the curve as they explore their options.

While common pros and cons are highlighted by financing type in the next section, keep the following general tips in your back pocket as you evaluate both the reasons you need financing and the type of financing to pursue.

- **Do the math on interest rates;** understand exactly how much the capital infusion is going to cost.
- **Understand target returns.** Some finance companies will require a target rate of return, in the event the target is missed, loan terms may adjust accordingly. Considering the change in terms in this event is critical to making the best decision for the business.
- **Watch for hidden fees;** when working with finance companies there may be origination fees that come off the top of the loan. When working with these companies, understand their fee structure.
- **Timing is key.** A company’s needs will impact acceptable timing of different financing types. Whether working with financial institutions, private lenders or investors, there is a detailed process. Learn approximately how long the process can take and keep this tip in mind: when they say, “two weeks,” it usually means two weeks from the time the borrowing company has correctly and completely submitted all the requested information.

We will note here that having an ERP system is invaluable in the due diligence process as access to accurate and auditable information can speed the process significantly. In addition, a fully-implemented ERP system not only improves operational efficiency, it can positively impact the valuation of a company in the event of a merger or acquisition.

Types of Financing

The financing options available to companies fall into two general categories: debt and equity.[6] *Debt* financing is borrowing money. *Equity* financing is giving a piece of ownership in the business in exchange for financial backing. Deciding between the two depends first and foremost on whether the ownership or existing shareholders want to give up a piece of the company in exchange for an infusion of cash. Securing either type of financing is dependent on internal and external factors. These are outlined in the next section: *The Financing Process*.

Debt, the more common and straightforward manner to secure capital, consists of many debt instruments[7] (arrangements or terms). The following provides an overview of the most common traditional and alternative forms of debt financing. These give manufacturing companies the flexibility to arrange for borrowing that best fits their needs or current situation. As outlined in greater detail in the previous section, regardless of the type of debt, answering the following questions will help find the best lender for the company's needs.

[6] There is a third type that bridges debt and equity: convertible debt. Convertible debt begins as a loan from an investor (or investor group) that can be converted to equity. Used primarily in startup and early stage company financing, convertible debt allows a company to secure investment without setting a valuation of the company. For that reason, it is less attractive to established companies, however, does provide an incentive for investment as a convertible note still accrues interest and provides a discount upon conversion.

[7] The term "debt instrument" is used to describe the all-encompassing provisions of the contract used to raise funds. Investopedia defines debt instrument as a documented, binding obligation that provides funds to an entity in return for a promise from the entity to repay a lender or investor in accordance with the terms of a contract.

- **Why does the company need funding?**
  - Opening a new location or acquiring a competitor?
  - Cash flow bridge?[8]
  - Planning a capital expense (CapEx)?

- **How much funding is needed?**
  - Have a complete understanding of what the company needs (and how funds will be used). Not securing enough can be more damaging than not securing any funding at all; if not enough funding is secured, a liability has been created without a substantial asset to offset it. In short, the company now has an additional debt obligation without funding sufficient to impact the reason funding was being sought.

- **What is the best type of lender?**
  - Should the company select a traditional commercial or community bank or private business lender? Time is usually a consideration. A commercial bank may have a long and rigorous vetting process, whereas private lender may move more quickly but have higher interest rates and fees. Commercial banks will also put significant weight on the loan-to-value (LTV) ratio.[9]

- **What type of funding is needed?**
  - Does the company need working capital or a line of credit? There are many considerations as outlined in this section. The main consideration is whether the company should take a loan, i.e., a lump sum amount with fixed repayment and interest terms or a line of credit, which allows the company to use and repay funds on an ongoing basis.

The following is an overview of the types of debt instruments most commonly used for securing debt financing. But first, additional considerations to keep in the back of your mind as you consider the type of funding that is best include:

- **Interest rates**
- **Qualifying standards (creditworthiness)**
- **Collateral requirements**
- **Repayment schedules**

The above constitute the "terms" of the loan. Longer-term loans may have lower interest rates; however, while the payments and interest may be lower on longer term loans, the interest paid will be more, making the money more expensive over time.[10] Another major consideration is the qualifying standards — what is needed to qualify? What is the creditworthiness of the business or ownership? Traditional loans may require personal guarantees (PG)[11] from ownership, real estate or another type of collateral. Alternative types of financing provide more "creative" and flexible opportunities to secure funding but usually charge a higher interest rate or require the company to take a discount. (see Alternative Financing below)

Whatever route the company decides to pursue, the more information it has, the more informed decisions will be made for the business.

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[8] A cash flow bridge, not to be confused with a Bridge Loan, is a short-term loan that provides funding for a quarter or short period. Bridge Loans– also known as interim financing or gap financing – are short-term loans that bridge the gap to cover expenses until long-term financing is secured.
[9] Loan to value or LTV is a calculation commercial banks use to asses risk, comparing the amount of the loan to the value of the use of proceeds.
[10] As it relates to borrowing, the cost of the money is interest rate you will pay to borrow – it is the fee you pay to use someone else's money. The cost of money to the lender is basically the interest they are missing out by not putting their money somewhere they could secure a higher rate, however, possibly in a riskier venture.
[11] A personal guarantee is the guarantee from an owner or executive of the company guaranteeing payment of a loan in the event the business does not pay.

Types of Debt

Traditional Financing

While there are nine major types of financial institutions, in general businesses work with two types — commercial banks and insurance companies. Commercial banks offer a range of traditional financing options depending on the financing needs.

The following are the most common types of traditional financing options available through commercial banks.

Secured or Unsecured, Revolving Line of Credit

A revolving line of credit (LOC) consists of funds that can be used as needed, is open-ended and as the line is paid down consistently, can be increased at the discretion of the lender. These can be procured either secured by collateral or as unsecured capital. An unsecured line provides access to capital without requiring collateral; the lender's decision on the amount is generally based on the company's cash flow and/or debt-to-income ratio.

Line of Credit

A standard line of credit, while also flexible, is a one-time loan. When the line is paid in full, the account is closed.

Business Credit Card

Business credit cards, either through your bank or companies such as American Express or Discover, can provide extensive lines of credit with additional benefits. For example, some cards allow for up to 60 days with minimum payments and a discount when paying early, which at times can be better than Net 60 terms from vendors. There are many options and when cash flow is a concern, a company card can provide the buffer between A/P and A/R.

Short-term & Long-term Loans

Short-term loans are generally less than 18-months. Be sure to use the right loan type for your needs. Long-term loans can be used for real estate or major equipment purchases. A short-term loan would be ideal for working capital or lower cost equipment.

SBA Loans

The Small Business Association (SBA) has many programs to help small businesses and works with lenders to provide loans. See SBA.gov for details.

As we prepared to release *Manufacturing Finance 101*, the impact of the COVID-19 pandemic was being felt across borders and industries. The following are included in the first edition, June 2020 as a resource:

COVID-19 Relief

Small Business Association (SBA)
SBA Disaster Loan Assistance
National Institute of Standards and Technology (NIST) Manufacturing USA National Emergency Assistance Program
State Small Business Relief Resources

Alternative Options

Financing programs outside of the traditional bank loan are referred to as *alternative financing*. Alternative lenders may not have the same credit standards as traditional lenders and can usually move more quickly. However, these usually come with higher interest rates, so the cost of money can be more than traditional financing.

When a company decides to explore these options, understanding the needs as outlined at the beginning of this section is even more important. It is also important to have a good understanding of the lender, their practices and reputation. We've all seen the Internet ads and especially in the climate of COVID-19, that have flooded our Email inboxes with financing offers. Taking time to do homework and learning about a lender is good business and the minimal due diligence a company should perform in its best interest. There are many large reputable alternative financing companies. There are also many that are *less than reputable* and can be predatory.

Alternative financing is a real option that serves a purpose and can help in a growth stage. Review the options and make the decision that is best for your business.

Purchase Order (PO) Financing

Think of PO Financing as an advance; the lender will pay your supplier for the goods you're reselling or distributing. A written PO is required, but you can finance up to 100% of the purchase order cost; depending on many factors. PO Financing is ideal for managing seasonal sales spikes when you have cash flow issues or when growth is outpacing lines of credit.

Pros	Cons
Easier to qualify	Monthly interest rates
Eliminates the need to turn away an order	If the buyer (PO issuer) has a poor credit history, this might cause an issue
Not a loan, so no monthly payments	Will impact the company's profit margin

Asset Based Loans (ABL)

This type of loan uses your assets to secure financing — either a line of credit or a lump sum loan. Primarily, ABL uses your accounts receivable (A/R) as collateral but can also use inventory, equipment or other assets. Generally, ABL allows between 75% - 85% of the value on A/R and 50% on inventory or equipment but may vary by lender and creditworthiness. These types of loans are also called *inventory financing*.

Pros	Cons
The company maintains ownership of collateral	Can be expensive
Can help when a company struggles with credit issues	Very strict due diligence process
Is revolving	

It is important to note that these are the types of loans where a solid ERP system can make the difference in the speed of securing financing. An ERP system can provide not only the value of the inventory — which any accounting system can do — but also provide the location of the inventory within a facility. In the due diligence process, depending on the amount of financing, lenders will require verification and can perform a site visit or field examination to ensure inventory is tracked and traceable.

Invoice Financing

This is a form of short-term borrowing that allows a company to use outstanding invoices to secure the loan. This type of financing can help when there are extended terms or customers that take longer to pay. Not to be confused with factoring, the borrowing company still owns the invoice and is responsible for collecting from customers. In *factoring*, the borrowing company sells the receivable at a discount and the factoring company collects from the customer. (see Factoring below)

Pros	Cons
Can be very fast	Can be very expensive
No additional guarantees required[12]	

Factoring

In factoring, the borrowing company sells open receivables at a discount to a company (called a *factor*) that collects from the buyer. While the percentage may vary, the factoring company will usually provide a percent of the value of the invoices immediately. Once paid in full, the *factor* will pay the balance to the company minus a fee and/or commission.

Pros	Cons
Immediate cash	Cost; varies but can be as much as 15% of the total invoice
Simple and straightforward; no collateral	Can depend on the customers payment history
Company responsible for unpaid invoices	The invoices are no longer an asset to the borrower; it becomes an asset of the lender
Doesn't add debt	

Peer-to-Peer (P2P)

Also known as social or crowd lending, P2P lending is a relatively new investment forum where websites, such as *Peerform* and *LendingClub* facilitate borrowing directly from individuals or groups of individuals.

Pros	Cons
Accessible for lower credit scores	High interest rates
Fixed interest rates and monthly payments	Missed payments will hit credit and will negatively impact ability to secure another P2P loan

[12] Terms and conditions vary by lender. The purpose of this information is intended as a general guide. xTuple is not a finance consultant or lender.

An alternative use-specific financing option is Equipment Financing.

Equipment Financing

The financing of equipment is one of the most common reasons for securing financing. In addition to traditional resources, there are many companies that specialize in equipment financing. Equipment financing loans allow a company to use the purchased or leased equipment as collateral. There are many variations on equipment financing depending on the specific industry and equipment.

Only the management of a company can decide if purchasing the equipment vs. leasing is the best decision for the business, but under either scenario, there are options that make it possible to get or replace expensive equipment.

Pros	Cons
Provides resources to buy, repair or lease	Restricted to equipment
Spreads the cost of the purchase; fixed cost	Can have higher rates than traditional loan
Serves as built-in collateral	

Regardless of the direction a company pursues, there will be a due diligence process — some longer and more involved than others. The section titled *The Financing Process* details the process and types of documents and documentation that may be required.

Vendor Credit

Also referred to as "trade credit," vendors may extend a line of credit for purchasing products/materials specifically from them. While the terms will vary depending on the vendor and/or existing relationship a company may have with them, these may also require some manner of guarantee or collateral.

Pros	Cons
Can help secure better pricing and secure solid relationships with key vendors	Use is limited to purchasing from the specific vendor
Helps reduce demands on working capital	Can negatively impact supply when/if payments are missed.

> "Risk more than others think is safe.
> Dream more than others think is practical."
>
> **— Howard Schultz, CEO of Starbucks**

Define the exact needs

Select the best type of debt financing for specific needs

Research lenders that provide the financing that will work best for the company

It is always good to start with financial institutions the company is already working with, as these may provide the best rate as a result of existing relationships/history.

Submit the application

There may be a preliminary approval based on providing information outlined in lender's due diligence requirements.

Submit documentation

Wait for final approval/funding

Work the payment schedule into financials

Equity

Equity financing consists of getting financing from investors or investor groups in exchange for ownership in the company. Equity financing can come in many forms and from diverse of investor types; however, it is either *public* or *private*. As we've highlighted more than once, *Manufacturing Finance 101* is not a master's class in finance, but rather an overview of the most basic options available. This section is a summary of equity investors and equity financing.

As stated in the debt section, the decision on which type of financing to secure — debt vs. equity — really comes down to whether the existing owner(s) want to give up a piece of ownership and, therefore, a piece of future profits.

Types of Investors

Angel Investor

Also known as private investors and seed investors, angel investors are high net worth individuals or accredited investors[13] that generally invest in startups.

Family Office

A family office is a private wealth management/advisory firm that manages investments for ultra-high-net-worth (UHNW) families and/or individuals. These provide services either to a single family or multiple families.

Friends & Family

A popular type of investor, "friends and family" are usually associated with a first round[14] of raising capital. Friends and family must still fall into the category of accredited investors. While there are some exemptions by state, before pursuing any investment from friends and family, understand the Securities and Exchange Commission (SEC) Rules, specifically Regulation D — Rules 504 and 506 on private placement.

Private Equity Investors

Private equity (PE) investors are individuals or firms that provide financing to various ventures in both the form of debt and/or equity. PEs also provide capital to established companies in need of funding to fuel growth.

Venture Capitalists (VC)

VCs are private equity investors that provide funding to startup companies with high growth potential in exchange for equity in the company.

[13] Accredited Investors are defined as individuals with an individual net worth of $1.2 M in total assets and annual income of $250,000.
[14] Any time money is raised from one or more investors in a business, it is referred to as a "round;" usually A round, B round, C round etc., because each follows the previous. The "friends and family" round usually precedes any formal fundraising rounds and is the first time an outside investment in the company is taken.

Types of Equity Investments

Initial Public Offering (IPO)

An initial public offering is the type of financing a company planning on "going public" is pursuing. This type of financing must be developed in compliance with the Securities and Exchange Commission (SEC) and requires extensive participation from expert professionals including, but not limited to investment bankers, attorneys and certified public accountants. Learn more about going public on the SEC site.

Mezzanine Financing

A combination of debt and equity, mezzanine financing gives lenders the right to convert debt to equity. Mezzanine financing is often associated with acquisitions and buyouts and is commonly used for expansion of established companies rather than startups. While favorable to the borrower because interest is tax deductible, the downside of mezzanine financing may mean the loss of control and upside potential through decrease in ownership (depending on the specifics of the financing structure).

Venture Capital

Venture capital comes from different sources including high-net worth private investors or groups of investors, investment banks and other financial institutions. Venture capital is generally associated with startup companies believed to have a high growth potential or have experienced high-growth early, on average within two years of launch.

Royalty Financing

An alternative to debt and equity, royalty financing, also known as *revenue financing*, is when a financing company provides capital in exchange for a percent of a company's future revenue over a pre-determined amount of time. Royalty financing can be used for growth, assets or operating expenses, such as launching a new marketing campaign. One way to think about royalty financing is as an advance on a company's future revenue with payments to investors as "royalties."

Foundational Requirements for Securing Equity Investment

- Executive Summary
  - 2-page document and/or short slide deck that summarizes:
    - Company History & Business Model
    - Historical Revenue, Gross Margin and P&L
    - Growth strategy
    - Financing sought and use of funds
  - This should firmly establish market viability and why this is a smart investment
- Non-Disclosure Agreement (NDA)
- Pro forma financials
- Deal Room
  - Also called a virtual data room, a deal room is a secure online repository for document storage and distribution to prospective investors.

Avoiding Pitfalls

Throughout *Manufacturing Finance 101*, we have steered readers to considerations that may help the decision-making process or, at the very least, help decision makers think holistically about the process as they consider the best financing solution for their needs. Here we've discussed some of the types of equity investors and investment types which a company needing financing might want to explore. In addition, the following considerations may help avoid some pitfalls:

- **Have a firm understanding of what existing ownership is willing to give up (equity, board seats, advisory roles, etc.)**
- **Confirm the investor(s) has the availability to fund.** Don't be afraid to ask questions. Understand the personality of the investor and how active or passive they plan to be. Aligning a company with investors experienced in the specific industry can be invaluable.
- **Understand the due diligence process early on; this cannot be stressed enough.** Seeking funding from investors involves a time and labor-intensive deep dive into a company's business and is not always the best route for short-term financing that is needed quickly.
- **Once you are provided with a due diligence checklist, make sure you send as complete a package as possible; do not "piecemeal" the information you send unless the investor(s) has specifically instructed you to submit information as it is becomes available.**
- **Ensure the internal team is ready to speak to prospective investors.** Investors will request a contact sheet for identifying people within an organization, key leaders they may want to speak with directly. Make sure everyone is on the same page as it relates to strategy, goals and success factors.

The entire process is discussed in greater detail in the next section. However, once the decision is made to pursue equity financing, and prospective investors have been identified, the process will generally flow as follows. However, it must be noted that the timing of securing equity financing rests primarily with three things: 1) how prepared a company is; 2) the accuracy of the company's documentation; and 3) the speed at which the investors want to move.

Securing equity financing isn't necessarily the recommended route when a company has an immediate need for capital. Outside of "friends and family," the process to secure equity financing can take months. Managing the process directly in-house is possible; however, input and advice from the company's CPA, attorney and business advisors will be critical to ensuring the most equitable arrangement.

> "If you're not a risk taker, you should get the hell out of business."
>
> **— Ray Kroc, founder of McDonald's**

Source Leads
Create Awareness/Generate Interest from prospective investors

Sign NDA

Preliminary Due Diligence

Investor Review/Investment Committee

Letter of Intent (LOI)

Due Diligence

Final Documents

Closing (Funding)

The Financing Process

It can be said that defining a company's needs and evaluating the options is the easy part; the process itself is what presents the greatest challenge. Among the many reasons xTuple is presenting this information is to help companies gain insight into the entire process. Despite the differences between the process for debt or equity financing, each will follow a basic flow as outlined below. The timing of each will depend on three primary factors:

- **The Lender or Investor**
- **The level of Due Diligence**
- **The level of preparedness of the Borrower**

Every lender has their own process. Most commercial banks have loan committees that review loans on a schedule, usually weekly or every other week. Private financing companies, those that provide alternative financing options, tend to move more quickly but still have definitive requirements as it relates to due diligence. Investors tend to move more slowly as their due diligence process is much more comprehensive and can involve everything from auditing inventory to interviewing the management team.

As highlighted in the ERP & Due Diligence infographic in this section, having an ERP system can reduce the overall time of the process by providing the capability to simply and quickly pull auditable information to provide to lenders and/or investors. Additional specific types of information are outlined in the section *Leveraging ERP — KPIs: What to Measure & Why*.

As it relates to transferring information, here's a tip: if a company has not in the regular course of business created and maintained a virtual data room — a secure online portal where key documents are stored and can be easily shared as needed[15] — putting this on the radar will prove helpful.

[15] Also called a deal room, a virtual data room (VDR) is a secure online portal that allows you to store and distribute documents. During the due diligence process a deal room is used to share and track key documents. This can be as simple as creating a structure and table of contents in Google Drive or as sophisticated as using a dedicated online service.

Due Dilligence

During the due diligence process, lenders and/or investors confirm the facts — everything from financials to the market viability of the opportunity. In this section we'll discuss the type of information different financing sources may require. We will also discuss the ways in which an ERP system contributes to the process.

As discussed previously, if you've ever applied for a credit card or purchased a vehicle, you've experienced some level of due diligence; verifying employment and income is a form of due diligence. Due diligence is the process of verifying basic information and assessing risk for lenders and investors.

The Process

The due diligence process allows lenders and/or investors to make informed decisions as to whether they should lend money to a borrower and under what terms. Basically, due diligence is how a lender uncovers any aspects of the business that can impact the terms of loan (e.g., interest rate, collateral, insurance, length, etc.) or may even cause the lender to withdraw from offering financing altogether.

As it relates to investors, the process will be much more detailed because investors are not making a loan; instead, they are taking a piece of ownership in the company, participating in the risk and hoping for a return. Unless the company succeeds, investors will see neither a return *on* their investment nor the return *of* their investment.

In addition to requesting information outlined in the next section, lenders and/or investors will most likely conduct a site visit or field examination.[16] Site visits can range from a walk-through of key decision-makers at a facility to inspect the operations and brief meetings with specific executives and/or managers to individuals taking up space in your conference room for a few days to a few weeks, again, depending on the type of financing.

Whatever direction a site visit or field examination takes, these are to assess the operation at every level and validate information. The speed at which information can be retrieved and verified will significantly impact the entire process, not only for the purpose of providing information, but also as a key indicator of how the company operates.

[16] A Field Examination is the on-site examination of a company's inventory, books and records usually conducted by an independent third-party pre-funding on behalf of a lender or investor.

The Process

Lenders

Complete Application

Due Diligence

Review / Approval

Final Docs

Fund

Investors

Initiate Contact; Introduce Opportunity
(initial “pitch”)

Sign NDA

Present the Opportunity

Preliminary Review
(evaluate the opportunity to see if they want to pursue)

Due Diligence

Go / No-Go

Go: Term Sheet

Final Docs

Fund

The Information

The following are categories of information that will be requested. See the *Due Diligence Checklist* section below for details and definitions of specific documents.

- **Corporate Information/Business Model**
- **Financial Information**
- **Revenue & Customers**
- **Expenses**
- **Transactions**

While every lender and investor will require varying levels of detail (generally in direct proportion to the amount of loan or investment) every type of document will fall into one of the above categories.

The Due Diligence Checklist

An Internet search of "due diligence checklist" will yield millions of results and every lender and investor will provide a detailed document at the beginning of the process. Some make this available even before the process formally begins as they too realize the time it can take to prepare and compile information.

Our checklist is not intended to be an all-inclusive list of requirements, but rather an overview of the type of information and documents that will be requested with tips we hope readers will find helpful. The primary intention of this entire eBook is to give manufacturing companies considering financing insight on the process and options and possibly help them prepare in advance of entering the process.

As our core expertise lies in ERP software, we also provide some insight into how to leverage a system to pull together information to help move the process along efficiently.

Corporate Information & Business Model

Corporate information includes all the documentation related to the structure of the company. The following may not apply to every specific company and is not all-encompassing but provides a general idea of the information that will be requested in the due diligence process. The information by traditional or alternative lenders may be limited to documents of incorporation. Equity investors will request the below items and any other documentation relative to the structure of the company.

- Incorporation Documents
- Corporate Bylaws
- Organizational Chart
- Lists of all securities holders
- Stock options
- Stockholder and voting agreements
- Warranties
- Stock appreciation rights, plans, and related grants
- Recapitalization or restructuring documents
- Minutes from all board, shareholder, and/or executive committee meetings since charter
- Agreements related to any sales or purchase
- Capitalization Table[17]

In addition to corporate information, a summary of a company's history, operation, products/ services, management team, revenue and projection, based on funding will be requested. These are usually highlighted in an Executive Summary, and is usually presented as a two-page document or brief slide deck.

An Executive Summary provides a very high-level view into a company and can provides prospective investors a window into corporate culture. The executive summary provides a concise snapshot of the following:

- **About the company — products, position and people**
- **About the market — this establishes the opportunity**
- **How the company operates — this summarizes production and distribution**
- **How it has performed historically — top line, gross margin and bottom line for at least 3 years**
- **The forecast (assuming funding) — outlines how the company will use the proceeds**

[17] Commonly referred to as a Cap Table, this shows the equity capitalization of a company, illustrating the breakdown of a company's shareholders' equity. In short, who owns how much of the company, including options granted to employees.

The Executive Summary is a key document early in the process critical to generating interest from investors but is also used to provide traditional and alternative lenders an overview of the company. This is not the place to wing it — ensure all information is accurate and can be verified.

- Company History
- Business Model
- Historical Revenue
- Market Opportunity
- Operations
- Sales & Marketing
- Competitive Overview
- Management Team
- Financials
- Funding Needed
- Use of Proceeds

Additional documents and information that will be requested include:

- **Planning Materials — Business Plan, Marketing Strategy, Product Roadmap, etc.**
- **Compliance Information — Regulatory, Environmental, Data Destruction, etc.**
- **Operations Processes / Certifications — Lean Manufacturing, ISO, and/or other**
- **Legal — Intellectual Property (IP), Actions, Contracts, Warranties, labor and employment contracts, channel contracts, etc.**
- **Human Resources — Organization Chart, Policies & Procedures, Bios of Key Team members, Employment Contracts, etc.**

Lean on ERP

An ERP system is the repository for the most accurate and up-to-date information and will allow a company to quickly and easily update information. Examples of information an ERP should help to quickly compile includes:

- **Historical Revenue**
  - **Topline Revenue**
  - **Net Revenue**
- **Gross Margin**
  - **By product**
  - **By customer**
  - **By distribution channel**

The dashboards in the system should allow a company to pull key performance indicator (KPI) graphs to summarize information at a glance. During field examinations and/or site visits, having an ERP allows borrowing companies the ability to continually update and provide information in real-time. Assuming all the inputs are accurate, this can go a long way with examiners.

Financial Information

The financial information requested will initially include historical financials and pro forma financials — the projection of what will happen to the Income Statement, Balance Sheet and Cash Flow Statement assuming funding is secured and goals are achieved. The details behind all of this information will also be required, and while evaluated differently, specifically as it relates to asset-based lending, a deep dive into inventory and costs will usually happen on site in a field examination.

- **Historical Financials**
  - **May require audited financials**[18]
- **Pro forma Financials**
- **Capitalization Table**
- **Tax Filings (usually a minimum of 3 years)**
- **Debts & Asset Liquidity**
  - **Promissory Notes, Loans, etc.**
- **Inventory information**
  - **QOH/Cost & Value/Location/Purchase Date**
  - **Historical Changes**
- **Accounting information**
  - **Revenue recognition**
  - **Aging A/R**
  - **Accounts Payable (A/P)**

Lean on ERP

All of the information outlined above with the possible exception of any promissory notes and tax filings, should be easily pulled from an ERP system. Managing information in a deal room allows a company to have a central location of core information that can easily be shared digitally. Pulling information from an ERP and moving it into a deal room streamlines the process and can significantly impact the time to closing.

Following review of financials, depending on the lender or investor, more details will be requested to identify weaknesses or strengths and can include any of the following, all of which are tracked and stored in an ERP to populate financial statements:

- **Cost of Goods Sold (COGS)**[19]
- **Sales, General and Administrative costs (SG&A)**
- **Operating Expenses (OPEX)**[20]

The *Basic Anatomy of Financial Statement* section provides a breakdown of financial statements, their use, where information can be located in an ERP system and highlights KPIs that prospective lenders and investors may examine.

For more detailed information on the KPIs manufacturers should be measuring, download the free xTuple White Paper: *The Key Performance Indicators Manufacturers Should be Measuring & Why.*

[18] Audited Financial statements have been prepared in accordance with generally accepted accounting principles (GAAP) and have been audited by an independent CPA.
[19] Cost of Goods Sold includes all the expenses directly related to the production of products such as materials and direct labor.
[20] Operating Expenses encompass the costs of day-to-day operation of the business such as rent, utilities, salaries / wages, property taxes, business travel – basically everything that is not in COGS

Revenue & Customers

Information included in this category encompasses all things sales and marketing,a or how a company goes to market. Maintaining current market and competitive information is invaluable in this process, giving a company the ability to validate the market opportunity. Key information to provide includes detailed growth plans. As the due diligence process progresses beyond the review of pro forma financial information or *what* will happen when a company secures financing, examination will shift to *how* the company will deploy funding and achieve stated goals.

Describing how a company has achieved sales to date establishes the foundation; however, detailing how the company will grow in the future substantiates the need for funding and more importantly, why the risk is worth taking for lenders and/or investors.

- **Growth Plans**
- **Products & Pricing**
- **Advertising**
- **Sales Channels**
- **Customers**
- **Market Validation**
- **Competitors**

Additional documents and/or information that may be requested include the following. Keep in mind, these do not need to be professionally created documents. The information provided can be overviews presented as concisely as possible; the most important element in any information provided to prospective funding sources is *accuracy*. A simple Google search of any of the terms will result in templates, examples and checklists to help a company create necessary documents.

- Marketing Strategy & Budget
- Competitive Analysis
- Situation Analysis
- Pricing Strategy
- List of Sales/Distribution Channels
- Customer List
- List of Primary Competitors with Market Share

Lean on ERP

In addition to giving the ability to quickly pull information from products and pricing, an ERP will give a company seeking financing the ability to easily provide pricing schedules by account, return information and a historical account of sales by customer.

When an ERP includes a CRM, in addition to providing details of sales by customer and distribution channels, highlighting top performers, a company should be able to quickly provide a deal pipeline — new business and/or incremental revenue the company is pursuing. When establishing the opportunity, questions about pipeline may arise. Having quick access to information not only helps validate the opportunity, but also helps speed the process.

> "The way to get started is to quit talking and begin doing."
>
> **— Walt Disney, Founder of Disney**

Expenses

In addition to company financials, details of expenses will be required — these allow lenders and/or investors to quickly identify areas of strength or weakness in operations and spending. These include:

- **Labor Costs**
- **Other Management Expenses**
- **Ledger Accounts of all revenue accounts and major expenses**
- **Detailed insurance costs (all types)**
- **Legal Expenses, professional charges and taxes**
- **Marketing expenses**
- **Technology expenses**
- **Management expenses**

Lean on ERP

Assuming accurate and updated inputs, the accounting functionality of an ERP should provide access to all of the above information with the ability to run reports by any given period.

Transactions

We're all familiar with the adage *the devil is in the details*. When lenders and/or investors are deep in the due diligence process, they often examine individual financial transactions — customer sales or purchases from vendors — in great detail. This is the type of information that is usually requested on the spot during a site visit or field exam.

For example, if a company sells through an ecommerce channel such as Amazon or to multiple channels through a platform such as Solid Commerce, transaction information requested might include the detail of transactions for a specific time period and through specific channels. Possibly to the effect of providing all B2B sales in seller fulfilled prime (Amazon) for a two-week period and the breakdown of selling price by SKU and the subsequent reconciliation with the cost of goods sold. This helps to better understand the viability of the product in general and specifically through the channel.

The above example might require a copy of the seller agreement with the channel and breakdown of all the channel costs to ensure the channel is profitable. While this example is extremely specific, it is a real-world example and hopefully provides insight into the types of detail that might be requested as related to transactions.

Timing

As discussed in previous sections, timing of the company's needs should be the consideration with the most weight as it relates to the type of financing pursued. Generally speaking, private lenders (also known as hard money), can fund in as few as 5 to 30 days. Traditional commercial lenders can take between 30 and 60 days, sometimes longer. The only thing a borrower can control is the third point outlined in the introduction to this section — the level of preparedness of the borrower.

The Basic Anatomy of Financial Statements

This is not a masters' class in finance. The intention of this *basic anatomy* of financial statements is to provide a 101-level view and definition of key concepts.

The term "financials" refers to three financial statements: Income Statement, Balance Sheet and Cash Flow Statement. When referred to as "pro forma" financials, it means the forecast of what could happen under specific assumptions — or projections — assuming specific goals are achieved.

These financial statements summarize the basic five drivers of business: Cash, Profit, Assets, Growth & People. *See the 5 Key Drivers of Any Business on Page 35 for more details.*

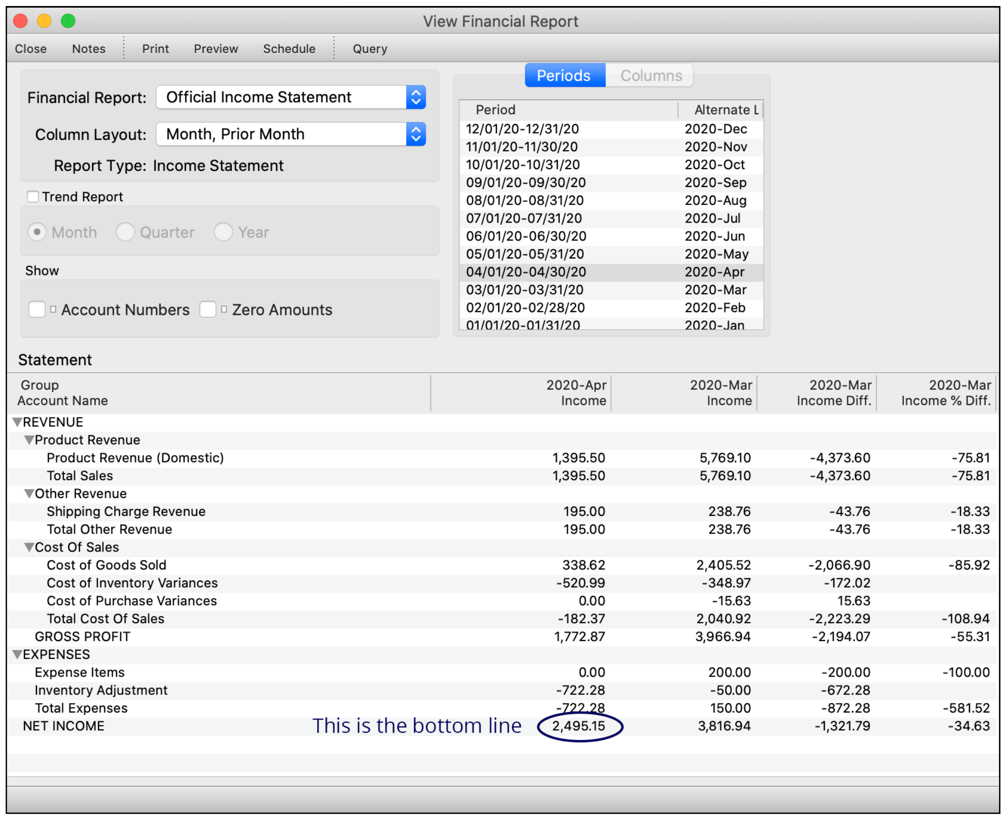
The Income Statement

The Income Statement reflects a simple equation and is where the *bottom line* resides.

Revenue – Expense = Profit

Also referred to as the *profit and loss statement* or *"P&L,"* the Income Statement indicates whether a company generated a profit or loss during any given period and highlights trends over time, allowing lenders or investors to evaluate the performance of a company quarter-over-quarter or year-over-year.

The P&L provides a quick glimpse into whether the growth rate has been decreasing, is steady or improving and gives a high-level view of how costs are trending as they relate to revenue.



Group Account Name	2020-Apr Income	2020-Mar Income	2020-Mar Income Diff.	2020-Mar Income % Diff.
REVENUE				
Product Revenue				
Product Revenue (Domestic)	1,395.50	5,769.10	-4,373.60	-75.81
Total Sales	1,395.50	5,769.10	-4,373.60	-75.81
Other Revenue				
Shipping Charge Revenue	195.00	238.76	-43.76	-18.33
Total Other Revenue	195.00	238.76	-43.76	-18.33
Cost Of Sales				
Cost of Goods Sold	338.62	2,405.52	-2,066.90	-85.92
Cost of Inventory Variances	-520.99	-348.97	-172.02	
Cost of Purchase Variances	0.00	-15.63	15.63	
Total Cost Of Sales	-182.37	2,040.92	-2,223.29	-108.94
GROSS PROFIT	1,772.87	3,966.94	-2,194.07	-55.31
EXPENSES				
Expense Items	0.00	200.00	-200.00	-100.00
Inventory Adjustment	-722.28	-50.00	-672.28	
Total Expenses	-722.28	150.00	-872.28	-581.52
NET INCOME	2,495.15	3,816.94	-1,321.79	-34.63

Leverage your ERP: the accounting functionality of your ERP should have built-in financial statements. Assuming accurate inputs – sales and cost of goods sold (COGS) – you should be able to run an Income Statement or provide key inputs for preparing a pro forma Income Statement.

Income Statement KPIs

- Revenue
- Cost of Goods Sold (COGS)
- Gross profit or gross margin
- Operating income
- Net income (profit)
- Earnings Per Share (EPS)

> “Rule #1: Never lose money. Rule #2: Never forget rule #1.
>
> **— Warren Buffett**

The Balance Sheet

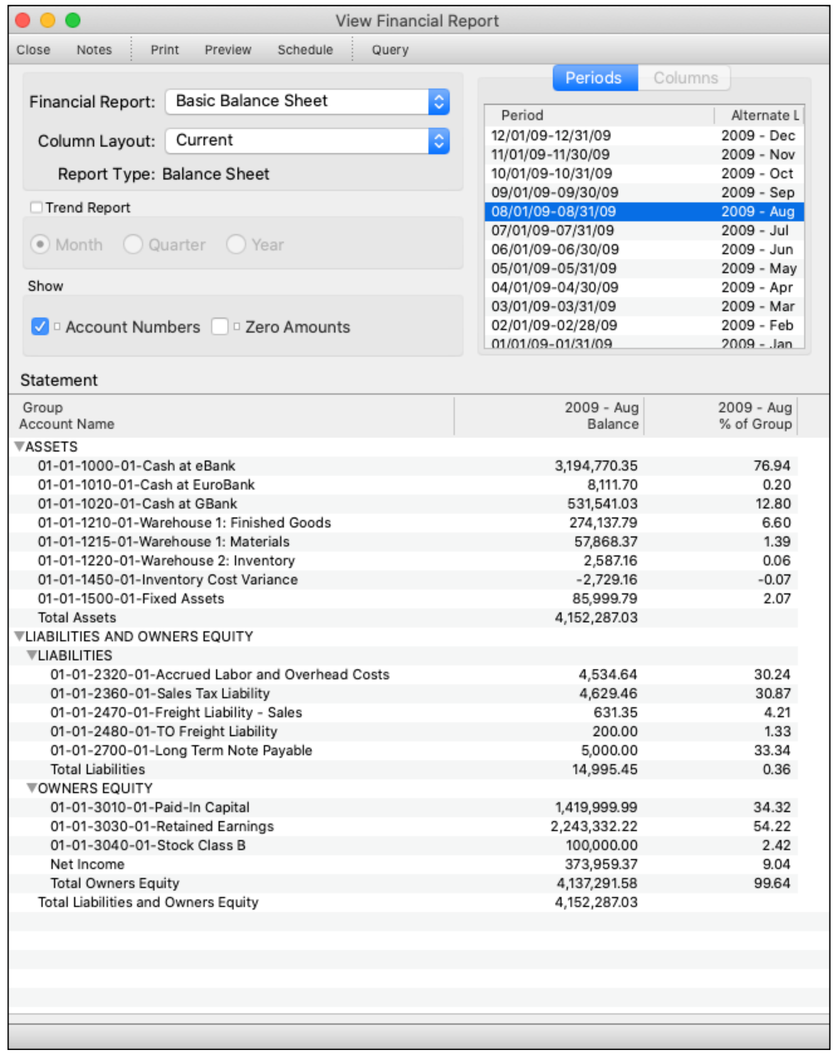
The Balance Sheet is a snapshot of the financial picture of a company at any given point it time — used to compare two periods — it provides information on the company’s cash position, change in cash position and equity ratio. **What does it all mean and why does it matter?**

The cash position refers to how much cash is on hand or accessible at any given time. This reflects a company’s ability to weather a storm — such as COVID-19 — or take advantage of opportunities — such as bulk discounts. The change in cash position illustrates what is happening with cash over time. The equity ratio shows the breakdown of whether a company’s assets have been generated by shareholders/owners or debt.

Taking the Net Income from the Income Statement and dividing it by the total assets on the Balance Sheet provides the return on assets (ROA) — or how profitable a company is in relation to total assets.

Return on Assets = Net Income/Total Assets

Why does the balance sheet matter? It is a key performance indicator — illustrating how well a company uses its assets.



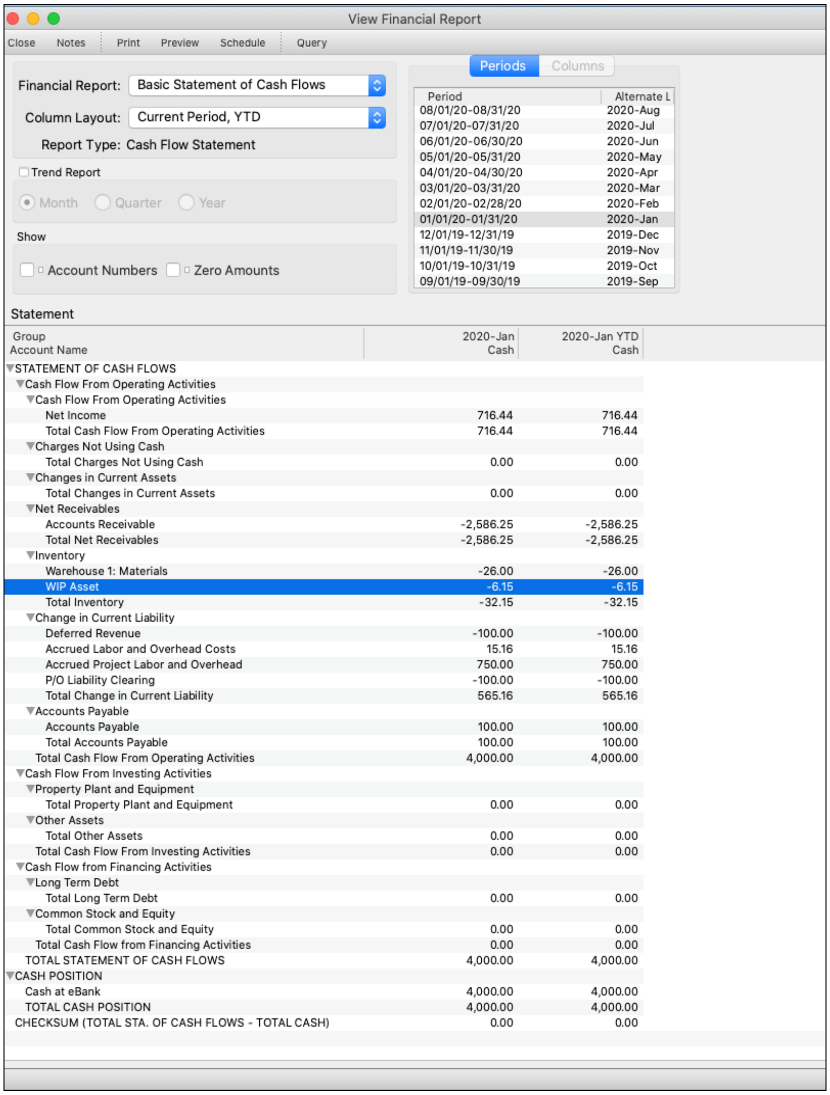
Group Account Name	2009 - Aug Balance	2009 - Aug % of Group
ASSETS		
01-01-1000-01-Cash at eBank	3,194,770.35	76.94
01-01-1010-01-Cash at EuroBank	8,111.70	0.20
01-01-1020-01-Cash at GBank	531,541.03	12.80
01-01-1210-01-Warehouse 1: Finished Goods	274,137.79	6.60
01-01-1215-01-Warehouse 1: Materials	57,868.37	1.39
01-01-1220-01-Warehouse 2: Inventory	2,587.16	0.06
01-01-1450-01-Inventory Cost Variance	-2,729.16	-0.07
01-01-1500-01-Fixed Assets	85,999.79	2.07
Total Assets	4,152,287.03	
LIABILITIES AND OWNERS EQUITY		
LIABILITIES		
01-01-2320-01-Accrued Labor and Overhead Costs	4,534.64	30.24
01-01-2360-01-Sales Tax Liability	4,629.46	30.87
01-01-2470-01-Freight Liability - Sales	631.35	4.21
01-01-2480-01-TO Freight Liability	200.00	1.33
01-01-2700-01-Long Term Note Payable	5,000.00	33.34
Total Liabilities	14,995.45	0.36
OWNERS EQUITY		
01-01-3010-01-Paid-In Capital	1,419,999.99	34.32
01-01-3030-01-Retained Earnings	2,243,332.22	54.22
01-01-3040-01-Stock Class B	100,000.00	2.42
Net Income	373,959.37	9.04
Total Owners Equity	4,137,291.58	99.64
Total Liabilities and Owners Equity	4,152,287.03	

Balance Sheet

- Current assets
- Total assets
- Current liabilities
- Total
- Liabilities
- Shareholders’ equity

Leverage your ERP: Assuming accurate inputs — accounts payable, accounts receivable, inventory, taxes, accrued payroll and related expenses — you can easily run a Balance Sheet to see how your company is trending. Your ERP should have a standard Balance Sheet built into its reporting capability.

Cash Flow Statement



Group Account Name	2020-Jan Cash	2020-Jan YTD Cash
STATEMENT OF CASH FLOWS		
Cash Flow From Operating Activities		
Cash Flow From Operating Activities		
Net Income	716.44	716.44
Total Cash Flow From Operating Activities	716.44	716.44
Charges Not Using Cash		
Total Charges Not Using Cash	0.00	0.00
Changes in Current Assets		
Total Changes in Current Assets	0.00	0.00
Net Receivables		
Accounts Receivable	-2,586.25	-2,586.25
Total Net Receivables	-2,586.25	-2,586.25
Inventory		
Warehouse 1: Materials	-26.00	-26.00
WIP Asset	-6.15	-6.15
Total Inventory	-32.15	-32.15
Change in Current Liability		
Deferred Revenue	-100.00	-100.00
Accrued Labor and Overhead Costs	15.16	15.16
Accrued Project Labor and Overhead	750.00	750.00
P/O Liability Clearing	-100.00	-100.00
Total Change in Current Liability	565.16	565.16
Accounts Payable		
Accounts Payable	100.00	100.00
Total Accounts Payable	100.00	100.00
Total Cash Flow From Operating Activities	4,000.00	4,000.00
Cash Flow From Investing Activities		
Property Plant and Equipment		
Total Property Plant and Equipment	0.00	0.00
Other Assets		
Total Other Assets	0.00	0.00
Total Cash Flow From Investing Activities	0.00	0.00
Cash Flow from Financing Activities		
Long Term Debt		
Total Long Term Debt	0.00	0.00
Common Stock and Equity		
Total Common Stock and Equity	0.00	0.00
Total Cash Flow from Financing Activities	0.00	0.00
TOTAL STATEMENT OF CASH FLOWS	4,000.00	4,000.00
CASH POSITION		
Cash at eBank	4,000.00	4,000.00
TOTAL CASH POSITION	4,000.00	4,000.00
CHECKSUM (TOTAL STA. OF CASH FLOWS - TOTAL CASH)	0.00	0.00

Cash Flow

- Cash from operating activities
- Cash growth from operating
- Cash used in (provided by) investing activities
- Cash provided by (used in) financing activities

Leverage your ERP: Assuming accurate inputs, your ERP should provide detailed Cash Flow.

Also referred to as the *statement of cash*, this represents money in and money out for a specific period. This flow of cash in/out is the reflection of cash generated from operating activities, investing activities and financing activities, defined as:

- **Operating Activities:** refer to what a company does, such as manufacturing, distribution, marketing, selling, etc.
- **Investing Activities:** refer to the cash generated from investment-related activities such as purchasing physical assets, investments or sale of securities or assets.
- **Financing Activities:** refer to cash generated from debt (borrowing), equity (in exchange for interest in the company) and dividends (payments to shareholders from profits or cash reserves).

Why cash flow matters? Aside from the obvious reasons and age-old adage *cash is king*, cash is the fuel to operate, pay debt, reinvest and/or pay shareholders and creates a "rain day" fund. Cash flow indicates an increase/decrease in liquid assets — showing lenders/investors how (wisely) a company expends cash — and ultimately if/how it will return value to shareholders.

5 Key Drivers of Any Business*

Financial statements provide a historical and/or current snapshot into the five key drivers of every business.

Cash
How you get it. How you use it. How much you have on hand (liquidity).

Profit
The difference between how much you make and what you spend to make it.

Assets
Everything of value, tangible or intangible, used to create revenue — employees, equipment, customers, etc.

Growth
Grow or die. Growth is the rate at which the top line (revenue/sales) and bottom line (profit) increase. Growth at the top is only good when it is positively impacting the bottom line.

People
People are what makes the business, literally and figuratively. Employees and customers are the most important stakeholders of any company. Employees make and sell your products, customers buy them, use them, talk about them and buy them again.

*The 5 Key Drivers of Any Business: As much as we would like to take credit for this simple way of summarizing business as it relates to financial statement, this concept is summarized in the book: *Seeing the Big Picture* by Kevin Cope. We highly recommend it.

“It is not the strongest of the species that survive, nor the most intelligent, but the one most responsive to change.”

— Charles Darwin

Leveraging ERP

As outlined throughout the previous section, an ERP will prove invaluable in accelerating the due diligence process while illustrating a streamlined operation. The diagram in the following section highlights where information is stored in the xTuple ERP platform; a similar structure should exist within most ERP systems.

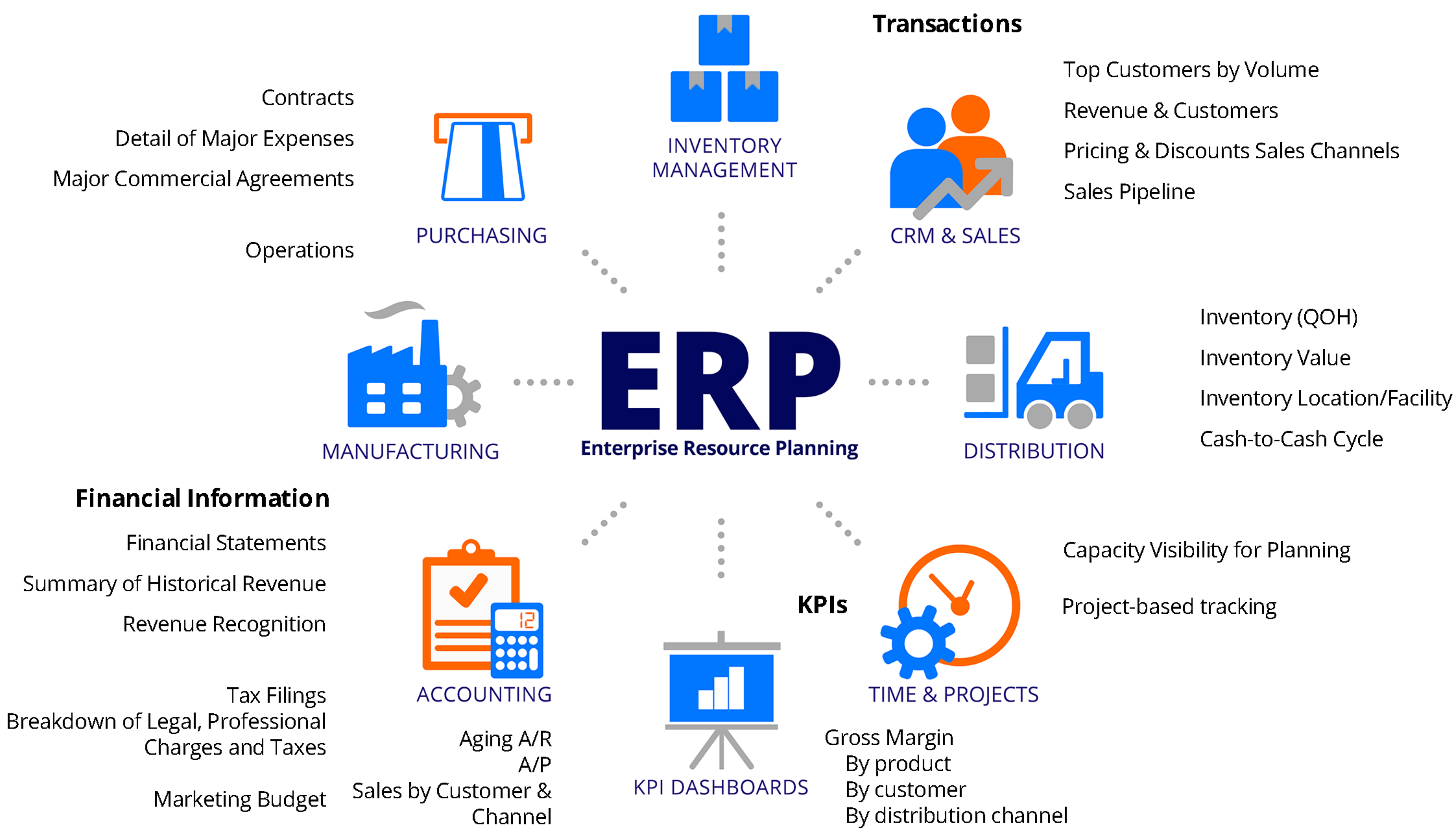
One of the most common misconceptions among small and mid-size manufacturers is that they are “too small” for an ERP system. Understandable given recent industry information on average cost of such systems, which ranges between $75,000 and $750,000.[21] Not to mention, that the average implementation takes up to 17 months.[22] But the fact is, there is no “too small,” and those figures might be misleading.

A manufacturer’s success rests in the ability to effectively manage processes, people and resources to measure productivity and performance. Whether a company’s revenue is $1 MM with a team of ten or $10 MM with a team of fifty, control over the entire operation is critical.

Sustainable growth requires refinement of the entire operation. Whether a company is funding its own growth through revenue/profit or seeking funding, visibility to understand how to best to leverage every area of the business to maximize efficiencies is key.

> “What gets measured, gets improved.”
> **— Peter Drucker**

[21] Source: BetterBuys “How Much Does an ERP System Cost? 2020 Pricing Guide”
[22] Source: Panorama Consulting “Panorama ERP Software Report 2018”


Transactions
Top Customers by Volume
Revenue & Customers
Pricing & Discounts Sales Channels
Sales Pipeline
Contracts
Detail of Major Expenses
Major Commercial Agreements
Operations
PURCHASING
INVENTORY MANAGEMENT
CRM & SALES
MANUFACTURING
ERP
Enterprise Resource Planning
DISTRIBUTION
Inventory (QOH)
Inventory Value
Inventory Location/Facility
Cash-to-Cash Cycle
Financial Information
Financial Statements
Summary of Historical Revenue
Revenue Recognition
Tax Filings
Breakdown of Legal, Professional Charges and Taxes
Marketing Budget
ACCOUNTING
Aging A/R
A/P
Sales by Customer & Channel
KPI DASHBOARDS
KPIs
TIME & PROJECTS
Capacity Visibility for Planning
Project-based tracking
Gross Margin
By product
By customer
By distribution channel

KPIs: What to Measure & Why

KPIs or *key performance indicators* are the most important metrics of business activity that show whether processes and people are delivering on expected results. Most importantly, KPIs show where the money is going, at a glance and in real-time. KPIs provide visibility into trends over time and quickly identify problem areas so major pitfalls that can impact a business can be avoided. Simply put, KPIs help a company learn from mistakes, fix problems before they happen and, ultimately, make more money.

Implementing an ERP system can give a company the ability to effectively and accurately track all the information necessary to make smarter business decisions. An ERP system should have built-in KPI dashboards or the ability to quickly access key information. However, if managing a business on spreadsheets or a proprietary system is working, what really matters is that the KPIs with the most impact on a business are measured.

Tracking the following and having them readily available to share with prospective lenders and investors will serve two purposes: 1) help accelerate the due diligence process; and 2) illustrate that continuous improvement is an active endeavor.

The following is not an all-inclusive list, but an example of some of the most impactful KPIs. More details are available by downloading the xTuple White Paper: *The KPIs Manufacturers Should be Measuring & Why.*

- **Total Manufacturing Cost per Unit Excluding Materials**
  Total Manufacturing Cost per Unit Excluding Materials is the labor costs and overhead costs of producing a single unit, item or volume. This allows you to measure costs that are potentially controllable.

- **Average Unit Contribution Margin**
  This represents the incremental money generated for each product/unit sold after deducting the variable portion of the company's costs. Measuring average contribution margin helps you understand the impact by unit of additional sales to the bottom line.

- **Cash-to-Cash Cycle Time**
  This measures the time between the purchase of inventory and the collection of payments for the sale of the products that utilize that inventory. This is key to understanding your cash flow and allows you to plan accordingly. This helps seasonal business or those carrying net terms both with vendors and customers to see when/if they may require additional capital to manage business operations.

- **Throughput**
  Throughput measures volume on a machine, line, unit or by plant in a specified period of time. While cycle times measure the time between two points, throughput must be monitored in real time for insight into issues on a production line. Throughput is impacted by many variables, including downtime, poor maintenance of equipment, too many steps in a process, and raw materials or tooling.

- **Capacity Utilization**
  This indicates how much of the total manufacturing output capacity is being utilized at any given time. This is key to understanding your ability to scale production.

- **Overall Equipment Effectiveness (OEE)**
  OEE allows you to measure the effectiveness of a piece of equipment or an entire production line by measuring Availability x Performance x Quality. This helps in yearly planning for CapEx and in production planning.

- **Schedule/Production Attainment**
  This measures the percent of time a target or production is achieved within a specified schedule of time. Measuring attainment allows you to examine everything from process to people for continuous improvement.

- **Yield**
  Referring to the non-defective units produced as a percentage of the total units produced, yield is one of the most critical indicators of quality and performance that directly impacts profitability. Like yield, scrap (materials discarded or rejected from the process) directly impacts the bottom line. While every manufacturer has their own definition of "scrap," tracking discarded items can lead to everything from refunds from vendors to increasing cycle times to focus on quality.

- **On-Time Delivery (OTD)**
  On-Time Delivery measures the percentage of orders delivered on time. The goal should be 100%. Manufacturers know the #1 killer of customer relationships is missing delivery dates. Tracking your OTD is key to maintaining happy customers, but likewise, tracking OTD from vendors can help ensure you're able to meet your customers' deadlines.

- **Rate of Return**
  This measures how many times customers reject products or request return merchandise authorization (RMA) based on the receipt of a bad or out of spec product. Selling is important, but keeping the product sold is equally important.

- **Work in Progress (WIP) Inventory/Turns**
  Critical in helping to reduce inventory, this ratio measures the use of inventory materials and is calculated by dividing the cost of goods sold (COGS) by the average inventory used to produce the goods.

- **Changeover Time**
  Changeover is the time to reset a production line. Over time, this can help you evaluate equipment, processes and team for improved performance.

- **Manufacturing Cost as a % of Revenue**
  This ratio is the total manufacturing cost of the revenue produced overall by a plant, business unit or product.

- **Productivity & Profit in Revenue per Employee**
  These measure the revenue and profit generated by each employee.

- **Net Operating Profit**
  Net Operating Profit is the profit remaining after subtracting the cost of goods sold (COGS), operating expense, interest and taxes and is reflected on the Profit & Loss Statement (P&L). Dividing this number by total sales provides the net operating margin.

- **Inventory Accuracy**
  Critical to production scheduling and on-time delivery, the accuracy of inventory is critical to efficiently managing the supply chain to ensure the optimal quantity on hand (QOH).

- **DuPont Analysis**
  The DuPont Analysis is one formula that allows a company to connect all the components that drive the value of the company. It gives visibility into how return is generated (from margin and efficiency). It also gives the ability to compare your business and economic strategy against peers.

$$\textbf{ROE} = \frac{\text{Net income}}{\text{Sales}} \times \frac{\text{Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Average Shareholder Equity}}$$

The DuPont Equation: In the DuPont equation, Return on Equity (ROE) is equal to profit margin multiplied by asset turnover multiplied by financial leverage.

Assuming all the inputs are accurate and up to date, an ERP will give you the ability to measure all of the above. Some systems, like xTuple, have the functionality to display KPIs in dashboard format.

If you have not yet implemented an ERP system, you can request a demo tailored to your specific needs by visiting xTuple online at www.xtuple.com.

Conclusion

Regardless of a company's financing needs or the type of financing sought, a robust enterprise resource planning (ERP) system can significantly impact the process. More importantly, an ERP system provides the power and functionality to manage the entirety of a company's operation and prospective lenders and/or investors will take notice.

According to a study by the Aberdeen Group[23], the absence of an ERP system results in redundant data, unaligned business systems and the inability to track processes in real time.

A recent independent survey by Panorama[24] found that post-implementation of ERP companies experienced positive results.

- **95% improved some or all of their processes**[25]
- **On average, companies experienced a 23% reduction in operations costs**
- **On average, companies experienced a 22% reduction in administrative costs**

How would any of the above impact your bottom line? For nearly 20 years, xTuple has been helping manufacturers grow to the next level. We understand the manufacturing process and challenges specific to manufacturers and distributors.

xTuple Mission

Deliver a robust, scalable and accessible platform backed by service excellence throughout our customer's lifecycle. Build on the foundation of our core values to achieve smart growth, profitability and ROI for all stakeholders.

Check the xTuple Calendar for upcoming live and on-demand Webinars. Visit xTuple.com to download our free White Papers.

[23] Accenture 2019 ERP Trends and the Aberdeen Group.
[24] Panorama Consulting 2018 ERP Report
[25] Panorama Consulting 2018 ERP Report

Glossary of Finance Terms

(This list is limited to terms relevant to and/or referenced in Manufacturing Finance 101)

Assets — are things you own. These can be cash or something that can be converted into cash such as property, vehicles, equipment and inventory.

Audit — a physical check performed by an auditor or tax official on a business' financial records to check that everything is accounted for correctly.

Bad debts — money owed to you that is unlikely to be paid to you in the foreseeable future.

Balance sheet — a snapshot of a business as of a particular date. It lists all of a business' assets and liabilities and works out the net assets.

Balloon payment — a final lump sum payment due on a loan agreement. Loans with a larger final 'balloon payment' have lower regular repayments over the term of the loan.

Bank reconciliation — a cross-check that ensures the amounts recorded in the cashbook match the relevant bank statements.

Benchmark — a set of conditions against which a product or business is measured.

Bill of sale — a legal document used in the purchase of property or other assets that details what was purchased, where the purchase took place, and for how much.

Bootstrapping — where a business funds growth purely through personal finances and revenue from the business.

Bottom line — see Net profit.

Break-even point — the exact point when a business' income equals a business' expenses.

Budget — a listing of planned revenue and expenditure for a given period.

Capital — wealth in the form of money or property owned by a business.

Capital cost — a one-off substantial purchase of physical items such as plant, equipment, building or land.

Capital growth — an increase in the value of an asset.

Cash — includes all money that is available on demand including bank notes and coins, petty cash, certain checks, and money in savings or debit accounts.

Cash book — a daily record of all cash, credit or check transactions received or paid out by a business.

Cash flow — the measure of actual cash flowing in and out of a business.

Collateral — see Security.

Contingent liability — a liability that only needs to be paid if a particular event or circumstance occurs.

Cost of goods sold — the total direct costs of producing a good or delivering a service.

Credit — a lending term used when a customer purchases a good or service with an agreement to pay at a later date (e.g. an account with a supplier, a store credit card or a bank credit card).

Credit limit — a dollar amount that cannot be exceeded on a credit card or the maximum lending amount offered for a loan.

Credit rating — a ranking applied to a person or business based on their credit history that represents their ability to repay a debt

Credit history — a report detailing an individual's or business' past credit arrangements. A credit history is often sought by a lender when assessing a loan application.

Current asset — an asset in cash or that can be converted into cash within the next 12 months.

Current liability — a liability that is due for payment in the next 12 months.

Debit — in double-entry bookkeeping a debit is an entry made on the left hand side of a journal or ledger representing an asset or expense.

Debt — any amount that is owed including bills, loan repayments and income tax.

Debt consolidation — the process of combining several loans or other debts into one for the purposes of obtaining a lower interest rate or reducing fees.

Debt finance — money provided by an external lender, such as a bank or building society.

Depreciation — the process of expensing an asset over a period of time. An asset is depreciated to spread the cost of the asset over its useful life.

Disbursements — money that is paid out by a business.

Discount — a reduction applied to a full priced good or service. See also Markdown.

Encumbered — an encumbered asset is one that is currently being used as security or collateral for a loan.

Equity — the value of ownership interest in the business, calculated by deducting liabilities from assets. See also owner's equity.

Equity finance — is money provided to a business in exchange for part ownership of the business. This can be money invested by the business owners, friends, family, or investors like business angels and venture capitalists.

Excise duty — an indirect tax levied on certain types of goods produced or manufactured in Australia including petrol, alcohol, tobacco and coal.

Facility — a predetermined arrangement such as an account offered by a financial institution to a business (e.g. a bank account, a short-term loan or overdraft).

Factoring — (also known as debtors finance and accounts receivable finance) is when a factor company buys a business' outstanding invoices at a discount. The factor company then chases up the debtors. Factoring is a way to get quick access to cash, but can be quite expensive compared to traditional financing options.

Finance — money used to fund a business or high value purchase.

Financial statement — a summary of a business' financial position for a given period. Financial statements can include a profit & loss, balance sheet and cash flow statement.

Fixed asset — a physical asset used in the running of a business.

Fixed cost — a cost that cannot be directly attributed to the production of a good or service.

Fixed interest rate — when the interest rate of a loan remains the same for the term of the loan or an agreed time frame.

Forecast — (also known as projection) a prediction of future financial transactions. Forecasts are often used to help plan a more accurate budget.

Goodwill — an intangible asset that represents the value of a business' reputation.

Gross income — the total money earned by a business before expenses are deducted.

Gross profit — (also known as net sales) the difference between sales and the direct cost of making the sales.

Guarantor — a person who promises to pay a loan in the event the borrower cannot meet the repayments. The guarantor is legally responsible for the debt.

Hire-purchase — a type of finance contract where a good is purchased through an initial deposit and then rented while the good is paid off in installments plus interest charges. Once the good is fully paid the ownership of the good transfers to the purchaser.

Initial public offering (IPO) — when a company first offers shares on the stock market to sell them to the general public. Also known as floating on the stock market.

Intangible assets — non-physical assets with no fixed value, such as goodwill and intellectual property rights.

Interest — the cost of borrowing money on a loan or earned on an interest-bearing account.

Interest rate — a percentage used to calculate the cost of borrowing money or the amount you will earn. Rates vary from product to product and generally the higher the risk of the loan, the higher the interest rate. Rates may be fixed or variable.

Inventory — an itemized list of goods or materials a business is holding for sale.

Investment — an asset purchased for the purpose of earning money such as shares or property.

Liability — a financial obligation or amount owed.

Liquidity — how quickly assets can be converted into cash.

Loan to value ratio (LVR) — your loan amount shown as a percentage of the market value of the property or asset that will be purchased. The ratio helps a lender work out if the loan amount can be recouped in the event a loan goes into default.

Margin — the difference between the selling price of a good or service and the profit. Margin is generally worked out as a gross margin percentage which shows the proportion of profit for each sales dollar. See also Mark up.

Maturity date — when a loan's term ends and all outstanding principal and interest payments are due.

Net assets — (also known as net worth, owner's equity or shareholder's equity) is the total assets minus total liabilities.

Net income — the total money earned by a business after tax and other deductions are taken out.

Net Profit — (also known as your bottom line) is the total gross profit minus all business expenses.

Net Worth — See Net assets.

Overheads — the fixed costs associated with operating a business such as rent, marketing, utilities and administrative costs. See also Fixed costs.

Owner's equity — See Net assets.

Plant and equipment — a group of fixed assets used in the operation of a business such as furniture, machinery, fit- out, vehicles, computers and tools.

Principal — the original amount borrowed on a loan or the remainder of the original borrowed amount that is still owing (excluding the interest portion of the amount).

Profit — the total revenue a business earns minus the total expenses. See also Revenue.

Profit and loss statement — (also known as an income statement) is a financial statement listing sales and expenses and is used to work out the gross and net profit of a business.

Profit margin — see Margin.

Projection — see Forecast.

Return on Equity (ROE) — is considered a measure of how effectively the management team is using the assets of the company to create profits. Calculated by dividing net income by shareholder's equity, ROE is the return on net assets and is equal to a company's assets minus its debts.

Return on investment (ROI) — a calculation that works out how efficient a business is at generating profit from the original equity provided by the owners/shareholders. It's a way of thinking about the benefit (return) of the money you've invested into the business. To calculate ROI, divide the gain (net profit) of the investment by the cost of the investment — the ROI is expressed as a percentage or a ratio.

(Net profit) / (Cost) x 100 = ROI

Example: Annie buys $1000 worth of stocks and sells the stocks a year later for $1500.

The net profit is $500.
ROI = (500 / 1000) = 0.5 x 100 = 50%.
Annie's ROI on the stocks is 50%.

Revenue — (also known as turnover) the amount earned before expenses, tax and other deductions are taken out.

Security — (also known as Collateral) is property or assets that a lender can take possession of, in the event that a loan cannot be repaid.

Shareholder's equity — see Net assets.

Stock — the actual goods or materials a business currently has on hand.

Turnover — See Revenue.

Variable interest rate — when the interest rate of a loan changes with market conditions for the duration of the loan.

Variable cost — a cost that changes depending on the number of goods produced or the demand for the products/service.