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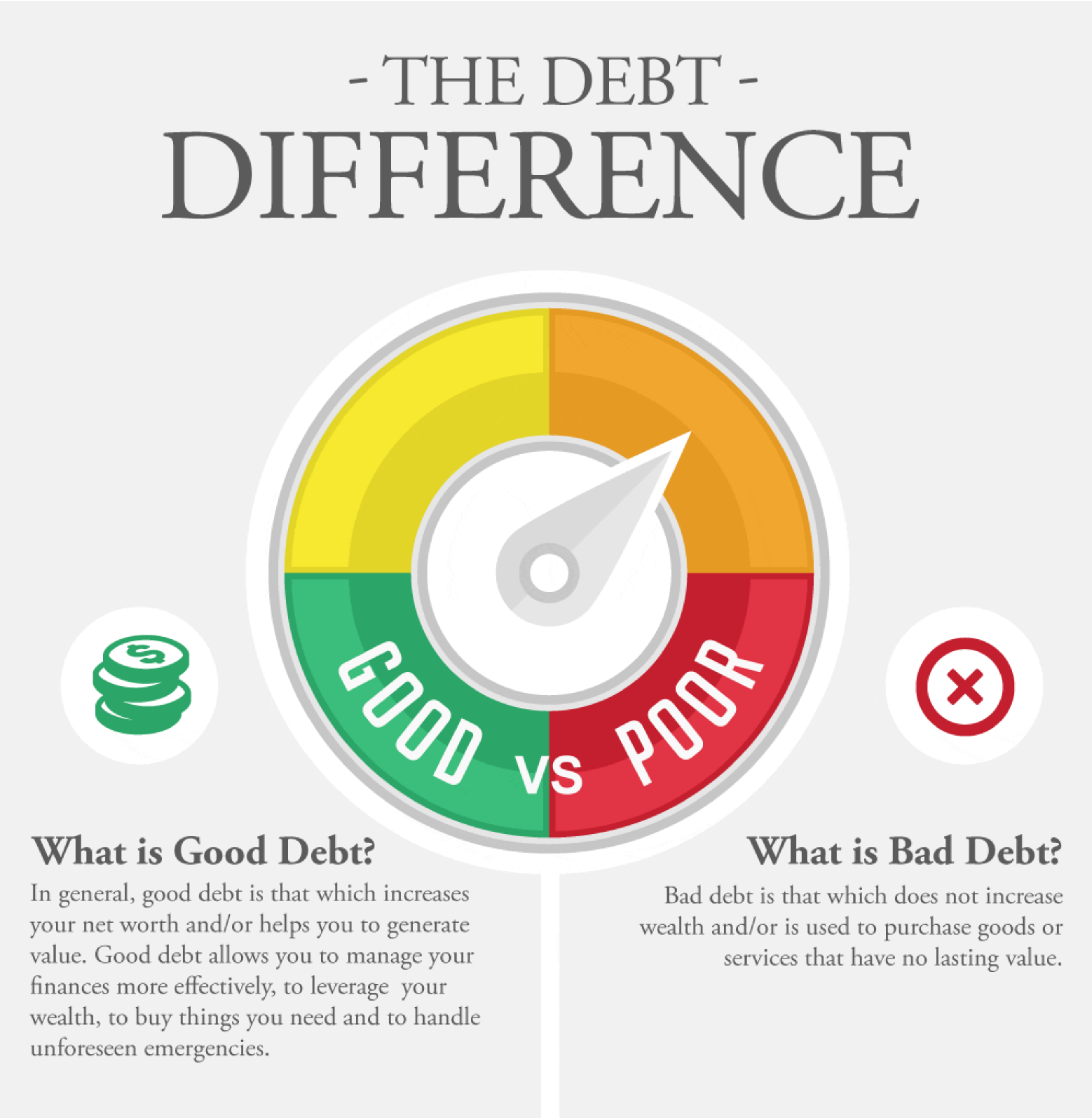
Starting a business in the world might seem easy, thanks to the power of the internet, automation, and lowered costs — but that isn't to say it's easy to find success and profitability with that same business. With more businesses starting daily, this leads to a larger increase in competition, and a great number of SMBs who aren't potentially ready for the fierce competition, compiling costs, and debt that might be right around the corner.

While most aspiring small business owners would love to launch a passion venture and not worry about how to pay for it, this is not the reality. According to the Small Business Administration, there are 27.9 million small businesses in the United States compared to 18,500 firms with over 500 employees. Those small businesses took out a combined $600 billion in business loans in 2015, and another $593 million from alternative means like finance companies and peer-to-peer lending platforms.

At the same time, it's also important to take a look at the number of startups and closures, and survival rates for businesses in the world today.

But despite the various loan options that exist, securing enough of the *right* debt is challenging. Yet, as the old adage says, ‘you need to spend money to make money,’ and without borrowing, it’s difficult for any business to grow their operation.

To ensure your business borrows for long-term success without jeopardizing long-term cash flow, here are six things to know about debt.



Good Debt vs. Bad Debt

Generally speaking, good debt refers to debt that can yield long-term income or growth in value whereas bad debt will not. For consumers, good debt might be a mortgage where bad debt would be a revolving credit card balance. In the business landscape, it's a little more nuanced and dependent on the specific company. You can learn more about the differences between these two here.

An example of good debt might be a company taking on debt to invest in certain employee programs, as the implementation of the program could lead to improved morale and better retention. It could also be debt used to do research and development for a new product since a new product line would generate more future income. A bad-debt scenario could be the result of a business taking out a loan for a larger business space that they don't end up filling or using adequately. Or a double whammy: paying for nice office space in a prime location when clients never see the office.

These situations can go on and on, and really hinge on the execution that does or does not take place after a loan is taken.

Healthy Debt-to-Income Ratios

Every business—even two competitors—have differences that affect what a healthy debt-to-income (DIY) ratio should be. Businesses might need different levels of debt depending on a multitude of factors.

So, while not a hard-and-fast guideline, generally speaking, businesses with DTIs under 1 have more stable debt levels while a ratio above 1 indicates that a company is more reliant on their debt. Calculate your business' DTI at any time by taking your monthly recurring debt payments and dividing it by your monthly gross income.

You Have More Leeway with Creditors Than You Think

Many business owners and individual debtors never try to improve on their existing terms or ask their creditors for any kind of compromise, even if it means falling behind on loan payments. But at the end of the day, banks want to see you succeed, if for no other reason than it means they're getting their money back. If you're proactive about needing aspects of your loan modified before you encounter difficulty paying it, you'll stand a much better chance of striking an agreement.

It's important to remember that creditor negotiations are a case-by-case basis. Whether you're trying to lower your interest rate, get a one-time payment grace period, or extend the repayment cycle, communicate how changing the loan will impact your business positively.

You Can Consolidate Your Debts

Even if you're keeping pace with your loans, juggling too many of them can be taxing, not to mention increase the chances you miss a payment date or don't have the cash flow you need at a certain time of month. Debt consolidation loans condense your monthly payments, due dates, and potentially, can net you a lower overall interest rate.

To learn more about this, also see my article on line of credit vs taking out loans.

Small business owners can attempt debt consolidation by taking out a private loan (though, a high credit score will be needed for favorable interest rates), opening a balance transfer card with interest-friendly (possibly free) introductory period, or seeking assistance through companies like Andrew Housser's Consolidation Plus, part of the Freedom Financial Network.

Layoffs Are Always a Consequence

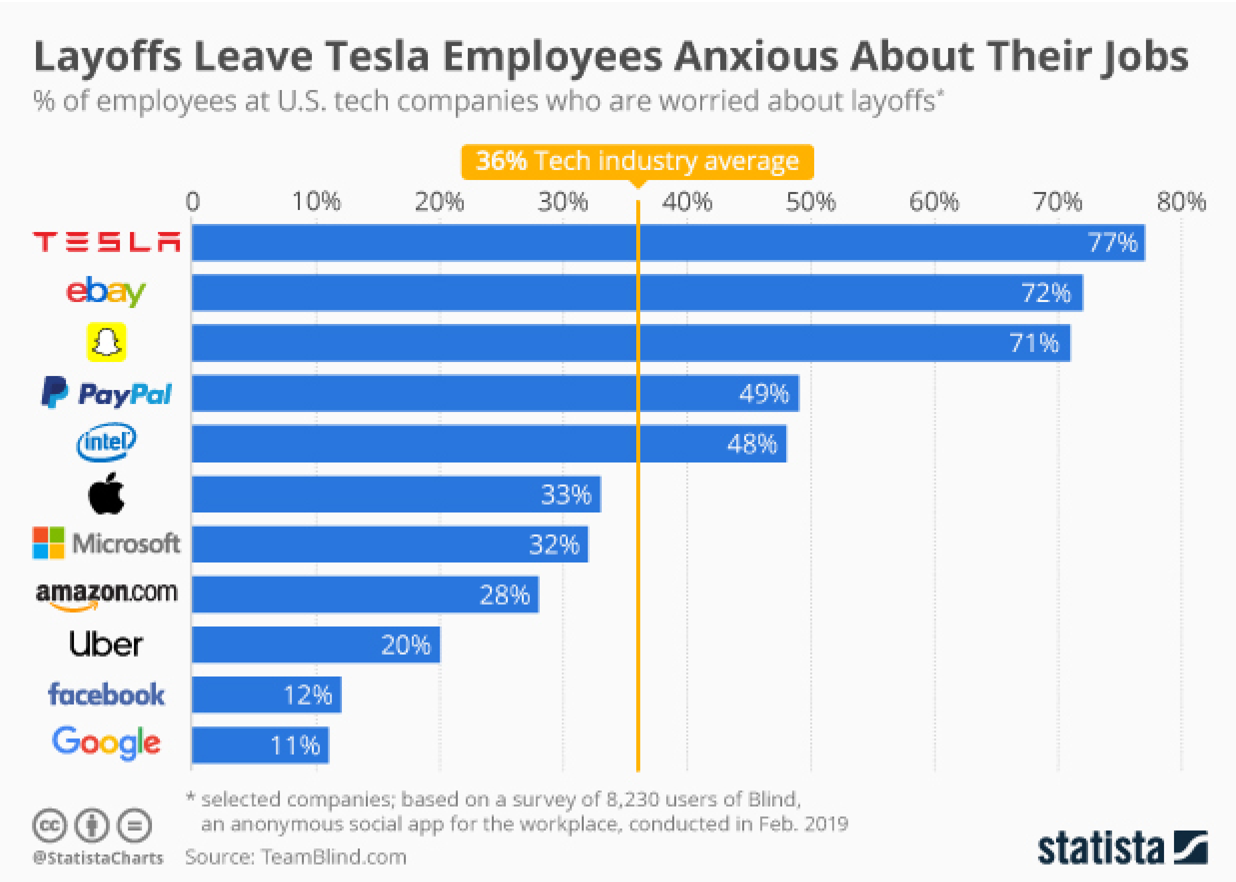
Small businesses are like tight-knit families. Limited bandwidth and resources mean that employees develop a sense of pride and camaraderie in working together (at least, when a business does well). And unlike a large company where turnover is rampant, employees tend to work for small businesses much longer.

Of the 5.6 million employer firms in the United States in 2016, organizations with fewer than 100 workers accounted for over 98 percent of the workforce. When small businesses take on debt to scale the operation, they need to understand that they'll need to cut costs if the investment doesn't pay off. Layoffs are a realistic consequence. And when a SMB starts laying people off, company morale will take a dive and could lead to lost productivity and even further turnover.

According to data from the Census Bureau's Annual Survey of Entrepreneurs, there were 5.6 million employer firms in the United States in 2016.

- Firms with fewer than 500 workers accounted for 99.7 percent of those businesses.
- Firms with fewer than 100 workers accounted for 98.2 percent.
- Firms with fewer than 20 workers made up 89.0 percent.

This also isn't just limited to small and medium sized businesses. Statista just recently had a report on big name companies like Tesla, eBay, Paypal, and more — all of which are leaving their employees hanging on whether or not they might have a long term relationship with the company.



Chapter 11 Bankruptcy Is a Last Resort

The thought of your hopes and dreams culminating in a bankruptcy court proceeding is certainly disheartening. However, chapter 11 becomes a viable strategy for business owners whose personal possessions are entwined in their business as it aims to restructure business debts to make repayments more manageable going forward without it sinking their business.

Just because taking debt is a necessary evil the majority of small businesses must face doesn’t mean it should be done so lightly. Leave no stone unturned in your search for a small business loan and consider these things above as you do so.

The Best Ways to Approach Debt Loss and Management for Your Company

No matter what position you might find your business in today, it’s important to realize that the first step in cleaning up an potential messes, is to ask for help.

This can be from people within your company, outside advisors, and of course — financial and legal institutions.

To learn more about managing company funds and debt, be sure to check out my other resource guide on paying off company debt.

The post What Every SMBs Need to Know About Debt and Growing their Business appeared first on Zac Johnson.