



Award Winning Bookkeeping
and Payroll Services for
Small Businesses

CASHTRAK

Finance Factsheet

Every business from its commencement and through its development and growth will need finance. But what type of finance is best suited to the development of your business, and who should you approach for funding?

Bank loans and overdrafts

The first place that most people think about when trying to obtain finance is their own bank. Banks are very active in this market and seek out businesses to whom they can lend money. Of the two methods of giving you finance, the banks, especially in small and start-up situations, invariably prefer to give you an overdraft or extend your limit rather than make a formal loan. Overdrafts are a very flexible form of finance which, with a healthy income in your business, can be paid off more quickly than a formal loan. If, during the period you are financing the overdraft, an investment opportunity arises, you could look to extend the options on your overdraft facility to finance the project. Many businesses appreciate the advantages of a fixed term loan. They have the comforting knowledge that the regular payments to be made on the loan make cashflow forecasting and budgeting more certain.

They also feel that, with a term loan, the bank is more committed to their business for the whole term of the loan. An overdraft can be called in but, unless you are failing to make payments on your loan, the banks cannot take the finance away from you. Many smaller loans will not require any security but, if more substantial amounts of money are required, then the bank will certainly ask for some form of security. It is common for business owners to offer their own homes as security although more risk averse borrowers may prefer not to do this. Anyone offering their house as security should consult with any co-owners so that they are fully aware of the situation and of any possible consequences.



Award Winning Bookkeeping
and Payroll Services for
Small Businesses

CASHTRAK

Another source of security may be the Enterprise Finance Guarantee Scheme. A start-up business unable to provide any other form of security may be able to get a guarantee for loans up to £1,200,000. Under the scheme, you pay a 2% premium on the outstanding balance of the loan, and in return, the government guarantees to repay the bank (or other lender) up to 75% of the loan if you default.

Savings and friends

When commencing a new business, very often the initial monies invested will come from the individual's personal savings. The tendency of business start-ups to approach relatives and friends to help finance the venture is also a widespread practice. You should make it clear to them that they should only invest amounts they can afford to lose. Show them your business plan and give them time to think it over. If they decide to invest in your business, always put the terms of any agreement in writing.

Issue of shares

Another way of introducing funds to your corporate business is to issue more shares. This is always a welcome addition to business funds and is also helpful in giving additional strength to the company's balance sheet. However, you need to consider where the finance is coming from to subscribe for the new shares. If the original proprietor of the business wishes to subscribe for these shares, then he or she may have to borrow money in a similar way to that discussed earlier. Typically, however, shareholders in this position are often at the limit of funds that they can borrow. Therefore, it may be necessary to have a third party buy those shares. This may mean a loss of either control or influence on how the business is run. An issue of shares in this situation can be a very difficult decision to make.

Venture capital

Approaching venture capital houses for finance will also mean an issue of new shares. The advantage of going to such institutions is the amount of capital they can introduce into the



Award Winning Bookkeeping
and Payroll Services for
Small Businesses

CASHTRAK

business. Due to the size of their investment, you can expect them to want a seat on your Board. They will also make available their business expertise which will help to strengthen your business, although inevitably this will come with an additional pressure for growth and profits. On a smaller scale, the government has introduced various tax efficient schemes for entrepreneurs to invest in growing businesses. The current schemes available are called the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCT). The SEIS is designed to help small, early-stage companies to raise equity finance by offering a range of tax reliefs to individual investors who purchase new shares in those companies. It complements the EIS which offers tax reliefs to investors in higher-risk small companies. The SEIS is intended to recognize the difficulties which very early stage companies face in attracting investment, by offering tax relief at a higher rate than that offered by the EIS.

Retained earnings and drawings

Since ultimately the well-being of a business is connected with the cashflow of that enterprise, if a proprietor would like more liquidity, then it is sometimes necessary to re-examine the amount of money they are withdrawing from the business for their personal needs. In this way, additional funds earned by the business can be retained for future use.

Other sources of finance

Other possible sources of finance are outlined below.

Factoring

Factoring provides you with finance against invoices that your customers have not yet paid. Typically, you can receive up to 85% of the value of the invoice immediately and the balance (less costs) when the customer pays.



Award Winning Bookkeeping and Payroll Services for Small Businesses

CASHTRAK

Hire Purchase (HP)

This is used to finance the purchase of equipment. Your business buys the equipment, but payments of capital and interest are spread over an agreed period.

Leasing

This is a method of financing equipment you do not need to own. It is often used for vehicle finance. The equipment is rented rather than owned and the rental payments spread over several years. There can also be the option to fix maintenance costs as part of the agreement (contract hire).

Matching

It makes sense to match the finance you are seeking to the purpose for which it will be used.

- Working capital - overdraft or factoring
- Equipment and vehicles - fixed-term loan, HP or leasing
- Property - long-term mortgage
- Development/start-up - investment finance

Planning for growth

Is finance required?

Finance is very often necessary but consider what it will entail. Additional funding requires a commitment in terms of capital and interest payments. Embarking on this course of action must therefore be planned carefully. The business must be capable of sustaining any additional commitment to growth or expansion, and consideration will need to be given to effects on manpower, materials, and space.



Award Winning Bookkeeping and Payroll Services for Small Businesses

CASHTRAK

Using existing resources

Before seeking outside finance, a business must consider whether it could improve its working capital from within. Particular attention should be given to stock and debtors to ensure that both are kept to a minimum. Consider how long it takes to bill customers and collect debts and look at ways to reduce this time. If there are periods of time when surpluses of cash arise, review your affairs to try and ensure these are being used to generate income by investing on temporary short-term deposit.

Business plan

Assuming external funding is necessary, planning is essential in achieving success. A well-drawn up business plan not only helps your own mind to understand the nature of the project, and the timing of any required funding, but is vital to any lending institution. They are unlikely to provide any assistance without a properly drawn up business plan.

The plan will include details of:

- the objectives and aims of the business
- the purpose of the required funding
- the business ownership and history
- management and responsibilities
- products and market share
- sales plan and strategy
- the financial position of the business with detailed cash flow forecasts and past accounts.

For more information, see our Business Plan fact sheet.

Types of finance

General

Finance is available in many forms, but it is important to make sure that it is right for your business. The wrong terms or inflexibility can hinder a growing business. The more obvious



Award Winning Bookkeeping and Payroll Services for Small Businesses

CASHTRAK

sources of finance include bank overdrafts and medium to long term loans and mortgages, but rates of interest can vary considerably. Therefore, we advise you seek professional consultation before making your final decision.

Specific

Specific methods of finance are available for acquiring assets or releasing cash from debtors. Carefully consider the options available which include:

- leasing assets
- hire purchase
- outright purchase
- debt factoring
- invoice discounting.

Each method of funding has advantages and disadvantages including implications for tax purposes.

Other

Other means of finance may be available for your business from government sources, through the issue of shares or even your own pension scheme.

Government assistance can be in the form of grants, loan guarantees or an enterprise capital fund. Other grants may be available on a regional or local level.

Raising finance by issuing shares may be another option to consider.

Security

Whatever form of finance is offered, the lender will always require some form of security. However, the level of security sought may vary - beware the lender asking for unreasonable guarantees.

Fixed and floating charges

Most bank loans and overdrafts are secured by way of a fixed charge over land and buildings with floating charges over other assets of the company such as stock and debtors.



Award Winning Bookkeeping
and Payroll Services for
Small Businesses

CASHTRAK

Personal guarantees

For some businesses little security may be available because of insufficient assets. Consequently the security will be given in the form of personal guarantees. Take extreme care before signing these guarantees as they can be difficult to amend at a later stage and many borrowers have suffered as a consequence. In particular, personal guarantees are best if they are limited by time or amount. Unlimited guarantees are the most dangerous.

General

It may be possible to use other assets as collateral such as life insurance policies or by taking a second mortgage over your home.

Whatever the means of security pledged, it should be carefully considered, and advice sought.

How we can help

We have a lot of experience guiding start ups and established businesses securing finance so contact us for a free one-hour consultation today.