Harlands Accountants

The 6 things you need to know about raising business finance

Your accountant can sort out your tax return or your annual accounts and provide advice on a range of issues, but how do you get the best return on the fees you pay to an accountant?

Start Up Finance will be needed for...

- Premises
- Equipment
- Goodwill if purchasing an existing business
- Installation of utilities
- Legal and professional fees
- Stationery
- Advertising and publicity
- Insurance
- Stock for resale
- Wages of employees

Then as you expand, further finance may be necessary to support any of the above that may increase before you make the sales and get paid. Businesses that are profitable can go bust if they don't have the appropriate finance arrangements in place to deal with expenses that need paying before their customers pay them.

You may have cash flow difficulties caused perhaps caused by needing working capital for debtors and stock or seasonal business variations. You need to try to match the appropriate source of finance for what you are trying to achieve. Generally, long term finance for long-term investment and short-term finance for short-term working capital requirements.

How to get YOUR bank to say “YES”

Banks are the major source of finance for small business in the UK. When applying for finance from you bank it helps if you follow these procedures…

Always produce a business plan. The main areas that need to be covered in a business plan are… Given frequently but don’t overdo it so it loses its effect!

- The management team background.
- The type of business.
- Previous trading history.
- Details of the market in which you are going to trade.
- Likely extent of the competition.
- How you will market your business.
- A cash flow forecast for at least the first 12 months that demonstrates you can meet the loan repayments and a project profit and loss account and balance sheet.
- Your break-even point.
- A SWOT analysis of Strengths, Weaknesses, Opportunities and Threats.
- Details of any expert advice you have sought.
- How much you want to borrow and over how long.
- Commitment from the borrower.
- What other sources of finance you will be using.
- Security being offered.
- What savings, investments and other assets you have

Other considerations

- Produce a 2-page summary of the plan.
- Ask for a 25% longer repayment than you need and 10-20% more money than you need.
- Send the plan to banks with an invitation to visit your premises.
- Prepare before meeting the bank manager. Think of the questions that are likely to concern them and have your answers prepared.
- Always negotiate the interest rate and terms after the offer has been made, not before. There is normally an arrangement fee of at least 1% for bank loans.
- Offer a charge on assets rather than personal guarantees.
- Try to avoid personal guarantees but if you have to give them ensure they are limited to the amount of the loan.
- Do not agree to too much security - only agree to the bank's maximum exposure to loss.
- Get the agreement in writing

Keeping the bank on your side

It helps to keep a good relationship with your bank and you can do this by...

- Keeping to agreements made - making payments on time, not going over your agreed overdraft limit, etc.
- If you are going to go over the limit or default on payment, warn them in advance.
- If there is bad news, let them know and let them know what you are doing to do to remedy the situation.
- Supply them with any information they require on time.
- Try to prepare the bank in advance for requests for additional finance.
- Borrowing for the right reasons

Bank Loans

May be secured or unsecured. Secured loans are just like a mortgage with repossession of the secured property possible in the event of default. The property could be your home. The loan may be used for a totally different purpose to the property on which it is secured.

The security may be a second charge on the property meaning that another lender has the first charge and the second lender only has the rights to any sale proceeds after the lender with the first charge. A lender with a second charge is therefore likely to charge a higher interest rate as would a lender of an unsecured loan.

Mortgages are the usual way of financing the purchase of commercial property with the loan being secured against the property, giving the mortgage company the right to repossess the property in the event of you defaulting on mortgage repayments. They tend to be for 10 to 25 years in length.

Factoring

Factoring is offered by banks and finance houses. The factor buys the debts off of you, paying you a high percentage such as 80% up front and then the balance when the customer pays the debt in full. They of course charge a fee for this. They are likely to charge 2-3% over base and a service charge of between 0.5 - 3% of your turnover, making them a potentially very expensive source of finance

They can also provide other services such as...

- Taking over the sales ledger administration.
- Assessing credit risks.
- Exporting assistance.
- Invoice Discounting
- Credit protection - for a further fee the factor guarantees 100% protection against bad debts. This is known as "non recourse".

Factoring your debts can be a good source of finance for those businesses that really need the money to help them grow. Viewing them as a finance source of last resort is probably the best approach to take.

Invoice Discounting

Similar to factoring, but all that is supplied is the finance facility against the invoices. There is no involvement with the sales ledger administration and the customer does not know the invoices are being discounted.

Hire Purchase & Leasing

With hire purchase you obtain the goods or equipment and make repayments (normally monthly) under a hire purchase agreement to cover the cost of the goods plus interest over a period of time. You own the goods or equipment once all payments have been made. The interest rate is often higher than for bank loans

Leasing

There are two types, purchase leases which are in essence just like hire purchase and operating leases. With operating leases you pay a rent for the use of an item and sometimes at the end of the lease there is an option to purchase the item or extend the lease with a reduced rental. Every lease is different and you need to look carefully at it. Leasing is available to higher risk cases that an unsecured loan may be because of the collateral of the equipment

Trade Credit

Trade credit when you buy from other suppliers is generally an interest free form of finance unless the supplier is prepared to offer a discount for payment up front. It therefore makes sense to take advantage of it. However, always bear in mind good supplier relationships are important to the success of your business and paying them on time or even in advance will contribute to this.

Equity Finance

This is not a loan but the person providing the finance becomes apart owner in the business, who may or may not be involved in the running of the business. It is important to fully understand the terms of the arrangement with an equity partner. It could be by giving shares in your Limited Company or by a partnership arrangement.

Venture Capital

The British Venture Capital Association www.bvca.co.uk represents companies offering venture capital. Apart from finance, the venture capital firm provides strategic support to the business, often with a seat on the board.

It is generally a higher risk type of investment where the Venture Capitalist is probably looking for a 300-500% return on their investment over a 4 to 5 year period. The amounts tend to be for over £100,000. Most investments take the form of equity capital

Business Angels

Business Angels are private individuals who invest on their own or sometimes as part of a syndicate for larger amounts. They rarely have a connection with the company before they invest but often have experience of its industry or sector. They look to invest both money and their business expertise.

Business angels usually invest between £10,000 and £250,000 in an investment. Business angels invest across most industry sectors and stages of business development, but especially in early and expansion stage businesses. Most prefer to invest in companies within 100 miles of where they live or work.

The National Business Angels Network is a good starting point to find a business angel.

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We can assist in advising on the most appropriate source of finance for you and in putting together your business plan.

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