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## Financing your start-up business

Establishing a solid financial base for your new business is essential. You need to be clear about how much money you are going to need and where to find it.

You also need to understand what the different types of finance can offer you. The right financial mix will cover your short term needs and allow you to make the most of growth opportunities as they arise.

### 1. Work out how much you need

#### Draw up a budget based on your business plan

- Show your forecasts for sales and expenditure, and what your cash position will be each month.
- Include capital costs, such as purchasing equipment.
- Be realistic. Sales might well turn out to be lower and later than you hope, getting paid may take longer and costs can be higher.

#### Work out how much financing you require and when you will need it

- A start-up business may spend more than it earns for two or three years. The amount of financing you need may continue to increase long after you reach breakeven.
- Seasonal businesses have predictable cash flow peaks and troughs. For example, a toy manufacturer might spend on producing stock all year, but receive most of the year's income after high sales at Christmas.

#### Allow for some contingency funding to cover unexpected problems

- Think of the worst-case scenarios that could affect your plans. For example, a product launch might be delayed, you could lose your best customer or costs might increase.
- Assess how accurate your forecasts are. If you are unsure, you might need sizeable contingency funding.

#### Arrange all your financing at the same time, in advance

- Don't wait until your need for extra funds becomes urgent.
- Let your bank know the total amount you want to borrow, even if you want to borrow in stages. Otherwise, asking for more funds a few months after you first borrow might alarm your bank manager.

## 2. Assess which funding is suitable

### Decide how much investment finance you need

- Businesses normally use investment finance to cover development costs and start-up losses. You cannot guarantee that you will have the profits to pay interest on borrowed money.
- Potential sources of finance include yourself, friends and family, as well as other investors.
- It will be difficult to borrow money from a bank unless you can point to an adequate initial sum that you have invested in the business. Showing that you are personally invested underline your commitment.

### Decide what short-term borrowings would suit you

- An overdraft is often the best way of funding working capital (the cash you need to cover the delay between paying suppliers and receiving payments from customers).
- You pay interest only on the amount you are overdrawn each day.
- Exceeding your overdraft limit incurs bank charges and higher interest rates. The bank may bounce your cheques, damaging your credit with suppliers.
- Other financing options include factoring.

### Decide what longer-term borrowing you want

- Loans and other forms of borrowing are usually the best way of financing equipment, vehicles and long-term borrowing requirements.
- Different forms of borrowing might enable you to raise more money than loans, but can involve higher costs.
- Most loans are for a fixed period of one to ten years. For property, you can use a long-term mortgage.
- The term of any loan should match, or be shorter than, the expected life of the asset you are acquiring. For example, if you are buying leased premises, the mortgage must be repaid before the lease ends.
- Using your overdraft to finance long-term borrowings can be disastrous. You might have no short-term finance available to you if your need for working capital increases.

### Check whether you qualify for any financial support

- There is a range of schemes providing help and finance for start-up and small businesses. Central and local government, business support organisations, some trade associations and charities all offer assistance.
- Areas such as exporting, technology and training are specifically targeted for support.
- Check what is available before you start trading, or you might no longer be eligible.

## 3. Sort out investment finance

### Decide how much capital you can afford to invest

- You might have cash you have saved or investments you can sell.

### Consider taking out a mortgage on your personal property

- You can then lend the money to the business.
- Mortgage rates are lower than business lending rates.

- Some mortgages have flexible repayment arrangements that can help reduce the risk of defaulting.
- Your home will be at risk if your business fails and you cannot make the mortgage payments.

## Consider asking family and friends to invest

- Make it clear that they should only invest amounts they can afford to lose.
- Show them your business plan and give them time to think it over.
- Discuss 'what-if' scenarios, such as what will happen if you go bust, want to pay yourself a big salary or want to take bigger risks.
- Put the terms of any agreement in writing.

## Consider whether outside investors are an option

- You are unlikely to attract outside investors unless you can show a strong track record and a credible business plan.
- You must be prepared to give up a share of your business. However, the investor might also bring experience that will drive your business forward.
- Investors will expect to be offered high potential returns to compensate for the risk they are taking. They will want an 'exit' plan so that they can realise their profits in three to seven years' time.
- 'Business angels' (wealthy entrepreneurial individuals) might be prepared to invest between £10,000 and £250,000 (and sometimes more). Find [business angel networks](#) through the UK Business Angels Association.
- Venture capital investors usually make investments of £1 million or more. Find [venture capital investors](#) through the British Private Equity & Venture Capital Association.
- Crowdfunding allows groups of interested investors to come together, each investing a small amount in the business seeking funding. Find [crowdfunding platforms](#) through the UK Crowdfunding Association.

## 4. Arrange overdrafts and loans

### Check what borrowing costs will be

- Interest rates are usually set at a margin over the bank base rate, which depends on how risky the bank thinks the loan is. Margins on loans are usually 2%–6%.
- Alternatively, the interest rate on a loan may be fixed at a flat rate.
- An arrangement fee is usually levied when an overdraft facility or loan is set up. Typically the fee is 1%-1.25% of the facility requested.
- A renewal fee is sometimes charged when an overdraft facility is extended.
- You might incur costs arranging security for borrowings.

### Compare different lenders to find the best deal

- Even if you decide that you want to stay with the bank you already have a relationship with, you will be in a stronger negotiating position.
- As well as talking to your existing bank, look at what might be available through government-funded initiatives such as the [Start Up Loans Company](#) and the [British Business Bank](#).
- [Peer-to-peer lending](#) platforms such as [Zopa](#) and [Funding Circle](#) match businesses in search of financing with individual lenders.

### Negotiate your overdraft facility

- Your overdraft limit is usually agreed for six to 12 months, after which it must be extended by negotiation.

- Your limit can be reduced if the bank decides this is necessary.
- In principle, the bank can demand repayment in full at any time, usually at just 24 hours' notice.

## Negotiate any loans

- Agree the term of the loan.
- Agree what the repayment schedule will be. Paying equal amounts of capital and interest is a common choice. Alternatively, you might be able to arrange an initial 'payment holiday' to allow time for your cash flow to pick up before the first payment is due.
- A fixed-rate loan makes it easier to budget for future costs.

## If you're turned down for a loan, don't give up

- The UK banks operate an independent-adjudicated [appeals system](#). Any business that has been refused credit by a participating bank has the right to appeal the decision.
- If you have difficulty borrowing from mainstream banks, you may be able to get financing from a [Community Development Finance Institution](#) (CDFI) or a [Credit Union](#).

## Security for borrowings

For any borrowing you need to show that you can afford the capital and interest payments. In addition, a bank usually wants security to ensure the loan is repaid if things go wrong.

### Assess what your business assets are worth as security

- Banks will value your assets conservatively when you use them as security. For example, they will usually lend only 50-60% of the value of business property and trade debtors.
- Short leaseholds offer little security.
- Small debts which are difficult to collect, old debts and any other doubtful debts will have no value.
- Equipment will be valued at its resale price (usually at auction). Specialised equipment that is difficult to sell and equipment which becomes obsolete quickly (such as a computer) will provide little security.
- Any existing financing arrangements, such as other loans or leasing arrangements, are likely to reduce the amount of security you can offer the bank.

### Decide whether you are prepared to offer a personal guarantee

- You might give a personal guarantee for business debts. Your personal assets (including your house) can be at risk if the guarantee is called upon. You should seriously consider how much you are prepared to risk.
- Sole traders and those in a partnership are already personally liable for all business debts.
- Directors of limited companies are often asked to provide personal guarantees in case the business fails.
- You might be able to negotiate a limit to the amount of any personal guarantee or how long it lasts.

### Another possibility may be the Enterprise Finance Guarantee scheme

- This may help if you cannot offer adequate security. Your annual turnover must be no more than £41 million.
- The scheme can be used to guarantee 75% of loans of up to £1,200,000.
- Repayment terms and interest rates depend on the lending institution. You also pay a premium of 2% a year on the outstanding balance, payable quarterly by direct debit.
- All the clearing banks, and a number of other private sector financial institutions, are partners in the scheme. Ask your bank manager whether you are eligible.

- The [Enterprise Finance Guarantee](#) scheme is operated by the British Business Bank for the Department for Business, Energy & Industrial Strategy (BEIS).

## You may need to take out insurance

- You can use insurance to pay out if you suffer an accident, sickness or death. This will also protect the bank if you are unable to work.

## 5. Arrange other financing

### Assess which are the best options

- Trade credit (paying your suppliers after 30 to 60 days) and bank finance may be all that a small business needs. Suppliers keen to enter a new market may offer extended credit.
- Leasing, hire purchase (HP) and factoring can each enable a business to raise more money than traditional bank finance, but the costs might be higher.
- Comparing the costs of different forms of finance is complicated. Key factors include fees, interest rates, the period of the finance and the tax implications. Ask your accountant for advice.
- Focus on cash flow first. Only if your cash flow is healthy and robust should you try to save money by relying on overdraft finance.

### Consider leasing equipment that you do not need to own

- Instead of buying the item, you rent it for a fixed period (usually three to five years).
- Payments are spread out over the period, helping your cash flow.
- You get full tax relief on lease payments (except for cars with CO2 emissions over 130g/km).
- You might get the option to purchase the equipment at the end of the lease period.
- Contract hire gives you the option to fix maintenance costs as well.

### Consider hire purchase as an alternative to leasing

- You buy the equipment, but payments of capital and interest are spread over a fixed period - usually three to five years.
- You can claim capital allowances for the equipment on your tax return, and the interest payments receive full tax relief.

### Consider using factoring to reduce the amount of capital tied up in unpaid sales

- You can receive up to 85% (typically 80%) of the face value of each invoice immediately, and the balance (less charges) once the invoice is paid.
- The factoring company collects payments on your behalf. Invoice discounting is a similar option, but you continue to collect payments yourself.
- It can be difficult to stop using factoring if you later want to switch to normal bank finance.

## 6. Work with your bank

Before lending any money the bank will want to see a viable business plan

- Your business plan must include a comprehensive budget.
- Your bank can advise you what information is required and how figures should be presented when seeking a loan.

Understand the importance of credit scoring

- Find out [how credit scoring works](#) and what you can do to ensure the best score possible, both for yourself and for your business.
- Depending on your credit score, you may find that some sources of funding are more easily accessible than others - for example, through your own credit cards or via a Credit Union.

Keep the bank informed

- Provide regular updates on the financial position of the business. This should include information on sales, costs and margins and updated forecasts for the future.
- Explain any differences between the figures you have achieved and your original budget.
- Mention any key events you expect (eg a new customer account you think you will win).

Warn the bank as soon as possible if you expect to run into difficulties

- Let your bank know in advance if you will be unable to make a loan repayment or expect to exceed your overdraft limit.
- If you have a good relationship with your bank relationship manager and you are open and honest about any short-term problems, your bank might be willing to temporarily extend your overdraft facility.

### Signpost

- Learn [how credit scoring works](#) and what you can do to ensure the best score possible.
- Find out about [government-funded financing initiatives](#) including the Enterprise Finance Guarantee and the Start Up Loans Company from the British Business Bank.
- Find [business angel networks](#) through the UK Business Angels Association.
- Find [venture capital investors](#) through the British Private Equity & Venture Capital Association.
- Find [crowdfunding platforms](#) through the UK Crowdfunding Association.
- Find out about [peer-to-peer lending](#) from the Money Advice Service.
- Find a local [Community Development Finance Institution](#) (CDFI) or [Credit Union](#).
- [Appeal a bank loan refusal](#) through Better Business Finance.

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