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What is the best way to Fund your business?

What are the best funding sources?
The best funding sources are internally generated, as they do not require using an external funding provider. Therefore the owner should first look critically at the levels of Debtors, Stock and Creditors. We can review your working capital levels and provide guidance on funds that could be generated this way, possibly avoiding the need to look at any other types of funding. Next the business needs to consider the security it can offer, is cash being generated, are personal guarantees a possibility (these should be avoided where possible and when insisted upon negotiated closely to achieve the best deal).

What is wrong with a bank overdraft?
Bank overdrafts can offer a convenient form of short term funding, however they are typically repayable on demand, leaving you at the mercy of your bank manager. Bank overdrafts should not be used where they are not effectively repaid over a 6 – 9 month period. If you can not repay your overdraft over this period it suggests that the funding requirement is more medium term and that a committed bank term loan facility may be more suitable.

Why consider a bank term loan?
A bank term loan will provide much greater security for the continued funding by the bank. However this form of lending is typically only extended on condition that your business complies with set bank covenants. The bank covenants are set once the financial business plan has been reviewed by the bank, and these are often subject to negotiation. If your business subsequently breaches any of the bank covenants, then the borrowing becomes repayable on demand. We recommend independent review of your business plan, examination of possible variations from plan, and advice on the negotiation of bank covenants, such as can be provided by **vfdnet**. Bank loans are typically secured by the bank on a bank debenture ie. a fixed and floating charge over all assets. Directors' personal guarantees should be avoided if possible.

Would Asset Finance be useful?
The business as a whole should be reviewed to see whether a reasonable amount can be raised from asset finance. Where suitable assets are to be purchased, then it may be wise to set up several Assets Finance facilities, ensuring that for any specific asset, funding can be secured at the best rate. Asset funding provided by the equipment supplier may often not be the most advantageous for your business. **vfdnet** has strong experience in setting up such asset finance facilities. Security on the funds provided is achieved through a specific charge on the asset in question.

What about using the Small Firms Loan Guarantee Scheme?
This is a useful source of funding, with the DTI providing 75% security on the bank loan extended. Banks still have a 25% exposure, hence they tend to apply their standard lending criteria, with the DTI requirements overlaid on top. You need to be able to demonstrate that you could not achieve any other business funding without the Small Firms Loan Guarantee Loan. These applications are complex and we recommend that we help you apply and respond to all the bank questions, knowing how the procedure works. This will give you the benefit of a much higher chance of achieving this type of Bank Loan.

How does Factoring or Invoice Discounting work?
Factoring is the full assignment of your book debts to the financial provider who acquires them and subsequently collects them from your customers. Invoice Discounting is a method of borrowing up to 80% against your Debtor book without your customer being aware of any change. Factoring and Invoice discounting can provide a flexible form of funding for high growth businesses, however if sales were to slow significantly then the borrowing facility will also shrink creating a funding pressure at the worst time. Certain businesses could be suitable for Invoice Discounting, however careful review of the type of sale and reliability of sales growth is essential prior to discussions with such providers. Beware banks trying to switch businesses away from bank overdrafts to factoring, following the recent Brumark legal case.

How should an owner invest?
If one of the owners of the business has further funds to invest, then the method of investing needs to be carefully considered. If the funds are only required for a short period, then a directors loan could be an option, whereas the state of the balance sheet will be critical in deeming share capital as being the advisable form. Tax aspects will need to be reviewed, and where there is more than one owner, a shareholders agreement should be considered.

What about Sale and Leaseback?
Sale and Leaseback of certain key assets such as land and buildings can be a useful means of releasing funding, particularly if you judge that property owning is not a core activity to your business. Potential funding providers will be keen to establish the 'covenant strength' of your business ie. how remote it is for you to fail to pay the rent. Rental costs of between 8 and 10% of the sales price would be typical. **vfdnet** can advise you on raising such funds against Buildings or even a vehicle fleet.

What about Business Angel funding?
If the other forms of funding can not be applied, you may wish to consider bringing in a business angel. A business angel will invest in your business for an equity stake, hence advice and preparation in your business valuation is critical. An alternative funding technique is via a convertible loan, which converts to equity later under pre defined criteria. The business angel will be

interested in investing only partly due to his financial return, often wishing to take an active part in the management of the business, so the personal chemistry will also be of great importance. Once more thorough preparation of your business is highly advised prior to entering into discussions with a business angel investor, and this can be provided by **vfdnet**.

The Venture Capital alternative

Venture capital will only be suitable for businesses which can demonstrate a strong and experienced management team, good growth prospects and realistic prospects for a medium term exit (3 to 5 years) from their investment. The Venture Capital investment process is usually well structured with detailed commercial and financial due diligence into the business, as the VC fund manager will wish to minimise his or her risks of a bad investment. Funding is likely to take the form of equity, loanstock and possibly equity warrants. Once more with any equity investment, valuation is key, and it therefore pays to get good advice to help maximise your businesses valuation.

Case Study

The client, an automotive engineering company, was experiencing strong organic growth and wished to move to larger and higher quality premises, intending to buy the premises freehold as part of an investment plan for future pensions. We expressed this strategy in a ‘bottom up’ financial business plan, identified a £4m funding requirement and then ran a bank tendering process between the incumbent bank and two others. Through thorough preparation and professional presentation, two alternative bank facilities became available, enabling the company to buy with certainty and to reduce the cost of the borrowing by £600,000 over 10 years

Disclaimer

This factsheet has been prepared by **vfdnet** based on extensive experience. However every business situation is different and no reliance should be placed on this advice alone. **vfdnet** does not accept any liability to readers of this factsheet. Owners wishing to seek funding for their business must seek professional advice such as that offered by **vfdnet**.