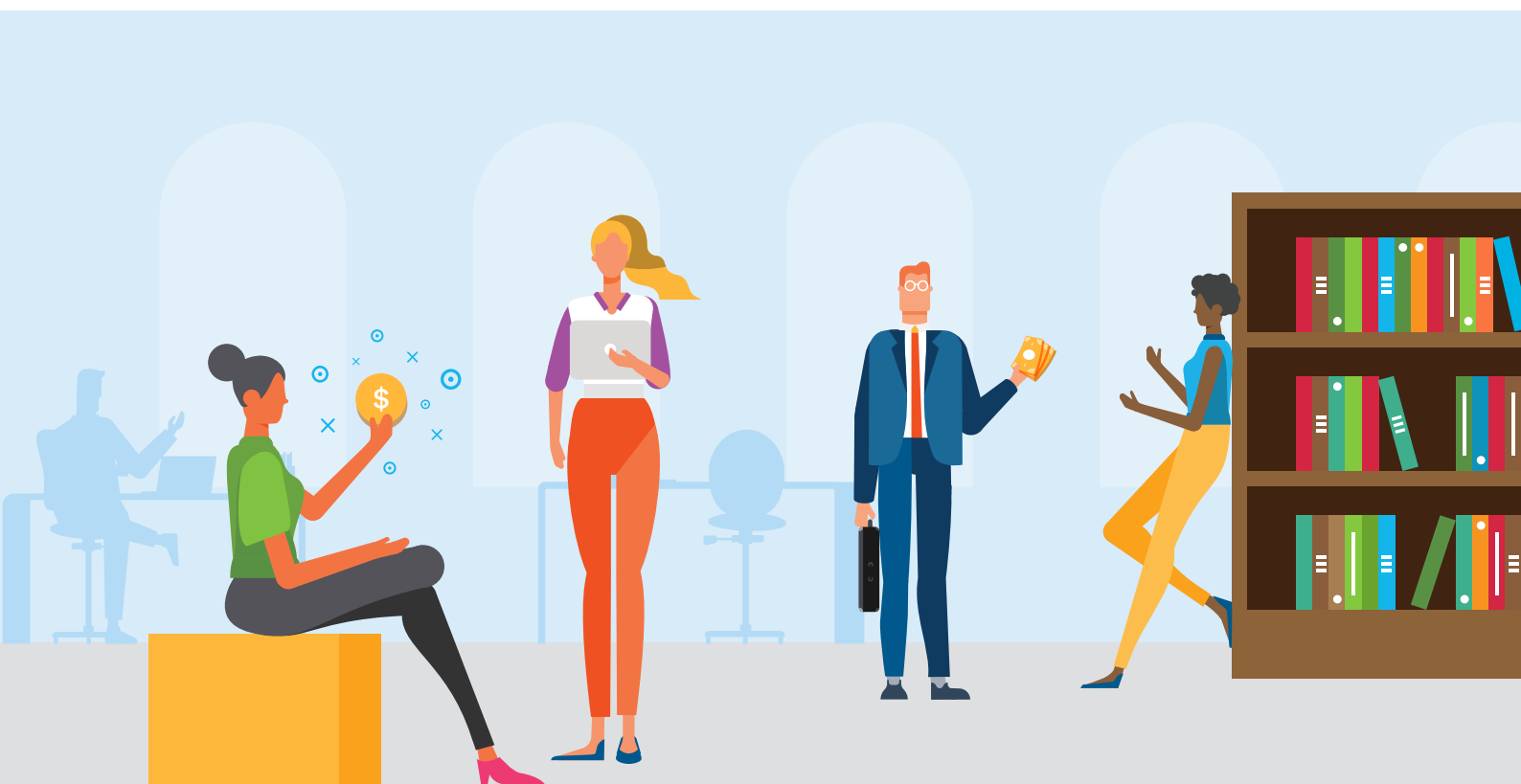


Your guide to financing your business



xero



Your guide to financing your business

Building and running a business can be expensive. Learn all the ways you can find that extra bit of cash to help make things happen.

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1

***What is
business finance?***

What is business finance?

Your new business idea is ready to go. Or maybe you're ready to grow your current business. If you don't have the deep pockets to finance it yourself, you'll need to find the right small business funding. But where, exactly, do you start?

Your business financing options

Most small business funding falls into one of two categories:

- **Debt** where you borrow an amount of money and pay it back, usually with interest
- **Equity finance** where you get funds by selling a share of your business to investors

You may end up with a mix of debt and equity finance. Bear in mind, too, that there are many types of finance within these main categories.

What's the right type of funding for your business?

Some types of funding are faster to get than others, some require more security, some are cheaper, some come with strings attached. You need to know what type is going to be best for your situation.

It's important to find funding that fits. You have a business to run. You don't want your financial arrangements to get in the way. They should be a sail not an anchor.



Seven questions to ask yourself about getting business finance

Before you go knocking on doors, there are a few steps you can work through to help you pick the right type and quantity of funding:

1. What are you funding?

Is it a startup? Are you buying a business? Or expanding an existing one? Are you looking to solve a cash flow problem? Some types of small business funding are better suited to different needs.

2. How much do you need and what will you spend it on?

Knowing how much you need, when, and what you'll spend it on will narrow down the best option for funding. Check out the next chapter on [how much to borrow](#).

3. Are your finance needs short or long-term, or both?

You may need short-term finance to get up and running, with longer-term finance to keep you afloat through the first couple of years. You can go to different places for each.

4. How risky is your business?

A proven business idea might make attracting some types of funding easier. But there are options out there for innovative business concepts. Can you find out where your competitors get funding from?

5. What's your history with business (or even personal) finance?

An existing personal or business relationship with a lender or investor might make it easier to get money – as will a good track record in business and of paying back debts.

6. What will it cost?

You can't get finance without it costing you or giving something up. You'll either pay interest to a lender, or turn over a share of profits to an investor. How will those costs add up over time?

7. Is it worth it?

Once you've figured out the cost of the finance, make sure it's worthwhile. Will the extra cash bring enough of an uplift in earnings or quality of life? In other words, what's the return on investment (ROI)?

Some funding fishhooks

Some business financing options might not be available to you.

If you're fresh off the blocks, traditional lenders might be reluctant to take a chance on you. They can't see your past performance or judge your skill at running a business. And if you have no assets to put up as security, it will be difficult to get a large loan.

Equity funding isn't an option for sole traders. If you want to sell shares, you'll need to be a company (although you can sell an interest in a partnership).

Don't give up though. There are a range of business funding options available, and being clear on your needs will help you find the right match.



2

***How much
business funding
do you need?***

How much business funding do you need?

Knowing how much money you need, and for how long, will help you choose the right type of finance to go for. Here are some tips to help you arrive at a number.

Business budgeting tips

It can be tricky figuring out how much money it takes to start, buy, run or grow a business. Here are some things to think about as you go through the process.

Starting a business

1. Building the business

List all the things it will take to get started. Include things like building fit-outs, vehicles, equipment, uniforms, initial inventory, website development, and promotion.

2. Running the business in the early days

Figure out what it will cost to pay leases, salaries/wages, suppliers, and utilities from week to week. Your starting revenue isn't likely to cover all that. How much more cash will you need?

3. Sneaky costs (that are commonly overlooked)

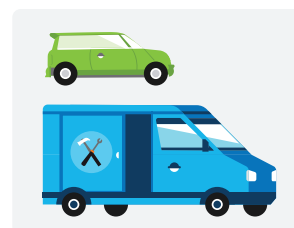
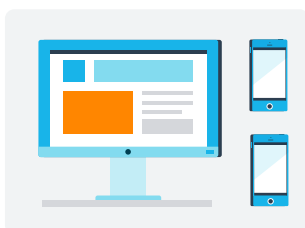
Startups commonly forget to budget for things like permits, rental bonds, insurance, utility connections, bank fees, website hosting, marketing costs to boost initial sales, and transport costs. Don't make those mistakes.

4. Wiggle room

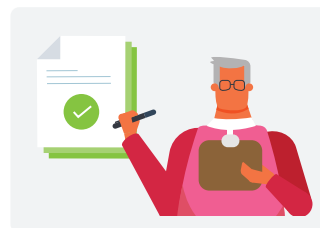
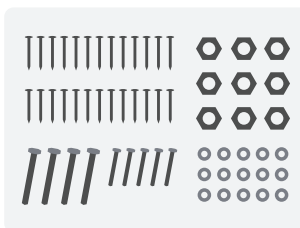
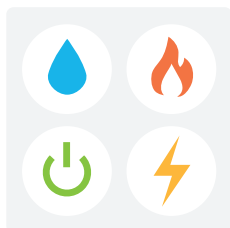
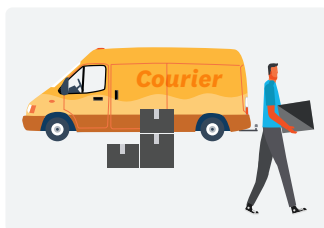
Things won't go as planned so put a buffer in your budget. You may need it to hire staff if things take off, or costs may go up if a cheap supplier goes out of business.

Don't just get into business, stay in business

It's easy to get preoccupied by the costs of starting (or buying) a business. Look beyond that. Ask yourself how much money it will take to run the business. Your revenue probably won't cover those costs in the early days.



Starting costs will include things like uniforms, office hardware, work tools, and maybe even vehicles.



Running costs will include things like transport, energy and utilities, inventory, and consultants.

Buying a business

1. Get a valuation

A professional valuation will help you decide how much a business is worth, and it will tell you if expensive equipment is due to be replaced.

2. Check the books

Have an accountant look at the past two years of business accounts to make sure it will make you money. Budget for an initial dip in revenue as customers adjust to new management.

3. Work out the cost of change

Will you be rebranding, hiring staff, buying extra equipment, or trying new marketing ideas? Estimate the investment required.

Buying a franchise

Some franchisors provide detailed budgets for buying and running the business, but that's not always the case. Check out our [guide on becoming a franchisee](#) for more tips.

Running a business

1. What is a working capital loan?

Day-to-day costs can be hard to cover if a big customer pays late, an unplanned bill comes in, or you have a bad month of sales. Working capital loans keep things running while you recover.

2. How often will you need one?

You may think you only need working capital loans at random times, but look for patterns. If it's regular and predictable, that may affect your finance strategy.

3. Avoid the high-interest trap

Working capital loans are often short-term and flexible. Because of that, they're high interest. If you need a lot of them, it will get expensive. Get an accountant to review your debt regularly. It might be worth converting some short-term debt to a lower-interest, long-term loan.

Growing a business

1. Make a budget

List all the costs involved in making the improvements, item by item. Get an estimate for each. If you need to operate at diminished capacity while the changes are made, factor that in too.

2. The hidden costs of growth

Work out what will happen to your operating costs after expansion. You may need more inventory or staff. Check your budget covers that, or that you can get a working capital loan.

3. Make sure it's worth it

Now you know the costs, figure out the return. Unless something's going to improve your profits or make business easier, it's probably not worth financing. Do a cost-benefit analysis.

4. Consider your finance options

Could you finance it yourself if your vendors gave you longer to pay? Maybe you could negotiate a deal? Or your vendors may be able to provide some finance of their own. Explore everything.

5. Think about cash flow

Remember that putting too much of your own cash into a purchase can backfire. If you run down all your reserves, you may have to take a short-term loan later and they have higher interest rates.

Get an accountant to look at your numbers

Getting finance always comes at a cost. An oversight here, or a miscalculation there can have big implications. Taking on debt or allowing investors into your business is a big deal. It's great to run the numbers yourself, but consult a professional before jumping in – they're the experts at budgeting and finance.

3

***Debt versus
equity finance***

Debt versus equity finance

Most forms of funding fall into one of two camps. You can get a loan, or sell a share of your business to investors. Let's look at the main pros and cons of debt versus equity and understand how they can help or hinder your business.

The difference between debt and equity funding

Debt is a loan that you have to pay back. Equity finance is what you get when you sell a stake in your business to someone else. They are very different things.

This doesn't have to be an either/or choice. A combination of both debt and equity funding might be best for your business at times. But it pays to know what you're getting into with each.

Pros and cons of debt vs equity financing

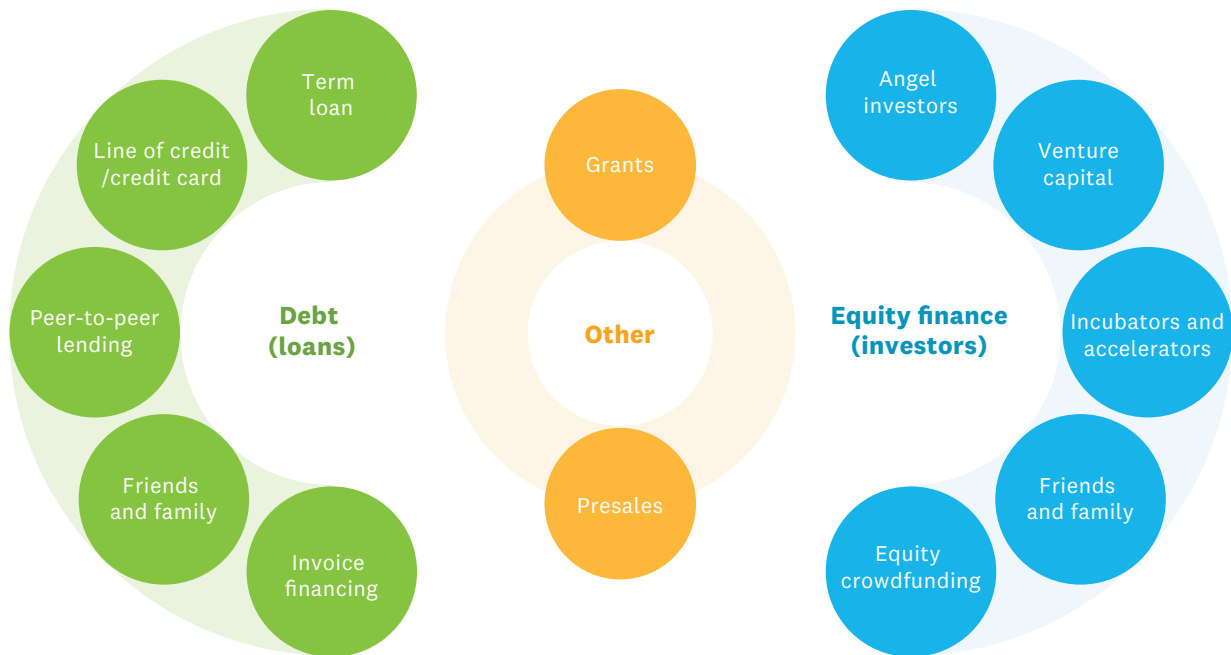
Debt (loans)		Equity finance (investors)
You're 100% in charge	 Ownership	You give up some of the business (and its profits)
Have to use some revenue to pay back loan	 Revenue	Can put revenue into growing the business
Harder to get if you're a startup, have poor credit history, or no security	 Availability	Support businesses that traditional lenders avoid
Straightforward but not always speedy	 Application processes	Pitches require a lot of time and you'll need lawyers
Regular with fixed or variable amounts	 Repayments	Dividends or returns expected eventually
May roll in other banking and credit services, plus insurance	 Extras	Access to investor know-how and networks
Vary according to business risk (and can be unpredictable)	 Interest rates	None
You may have to mortgage your house to get big money	 Security	Not required
You still owe the money (or security)	 If the business fails	Investor loses their money
Lenders want to know you'll repay them	 Expectations	Investors want to know you'll grow and make money for them
There's no obligation once the funding is repaid	 Exit strategy	You're not the only owner so getting out is complicated
There's usually no regular reporting obligations	 Reporting	You have to provide reports to shareholders

4

Main types of finance

Main types of finance

It takes money to make money. So what sort of finance options are out there?
Here are the types of finance that fund most businesses.



Debt (loans)

Term loan

A lump sum repaid over a fixed time

Line of credit/credit card

Funds that are available to use when needed

Peer-to-peer lending

A crowdfunded loan

Friends and family

When those close to you lend you money

Invoice financing

An advance on the invoices you've issued

Other

Grants

Funds that don't have to be repaid

Presales

Customers pay before an item is generally available for purchase. This can include [rewards-based crowdfunding](#).

Equity finance (investors)

Equity crowdfunding

Where the public can invest in your business

Angel investors

Individuals who invest their own money

Venture capital

Professional investment groups

Friends and family

When those close to you buy into the business

Incubators and accelerators

Development schemes to build and boost small businesses

Main types of finance



The type of finance you choose matters

When you're desperately keen to buy, start or grow a business, you may feel like any finance will do. Don't fall into that trap. Choosing the wrong type of finance could break your business later, or severely hamstring it.

Each finance type has its own pros and cons. Use this guide to learn about them. Ask which suits your business, and you as a person – because that matters too.

Begging, borrowing, and bootstrapping

Some businesses don't require a lot of money or capital at the outset. For example, you might only need a laptop and an internet connection if you're offering a home-based service like proofreading or bookkeeping.

Other businesses start out really small, with minimal money, and build slowly. This is often called bootstrapping. In these cases, it's common for owners to cobble together their own finance through personal savings, personal loans, or taking extra shifts at their day job. Even if you're doing that, it's worth knowing about the types of finance out there. You may just need an extra injection of cash down the road to get the business truly humming.

5

***How to get a
business loan***

Getting a business loan is still one of the most common ways to finance a business. So let's look at how they work, who's behind them, and how to get one.

Types of loans

Business loans tend to come in one of two basic forms:



Term loan

A lump sum you get all at once, with a regular repayment schedule over a set period of time.



Line of credit

A pool of funds you can dip in and out of with flexible repayment amounts and interest charged only on the amount of money you use.

What are term loans?

Personal term loans, business term loans, startup loans, business mortgages, commercial property loans, and asset loans are all types of term loans. These names denote the purpose of the loan, which may affect the amount you can borrow.

Where term loans vary is in the interest rates charged, repayment terms, and security required. Let's look at those options:

Interest rates and repayments

- **Fixed:** You lock in one interest rate over the term of the loan. This can help with budgets and forecasting. But you're likely to be charged an early repayment fee if you pay back the loan before the end of the fixed term.
- **Floating (or variable):** The interest rate can go up or down. If the rate goes up, so do your repayments. But if it goes down, you can either reduce your repayments or leave them the same and pay off the loan faster. Floating rate loan repayments are often more flexible; you can change the repayment amount, pay off lump sums whenever you like, and often pay the whole loan back early without penalty.

Security

- **Secured:** If you can provide some type of valuable asset or personal guarantee as security you may find it easier to borrow, and get a larger amount. But if you fail to make repayments, the lender can take the security as their own. Some lenders might offer partially secured loans where the security isn't worth the full value of the debt.
- **Unsecured:** This is a more expensive but less risky option, where you promise nothing as security. Interest rates and fees tend to be higher and it's hard to get if your credit history is poor. The amount you can borrow is also generally lower.

Term loans are often used for long-term investments, such as buying a business or large assets. They're also a good option for businesses with regular income because they can budget repayments and term loan interest rates are lower than line of credit rates.

The longer you've been in business the easier it usually is to get a term loan. Lenders like to see a successful track record.

What is a line of credit?

Revolving credit facilities, overdrafts, and credit cards are all a type of line of credit. They give you access to extra cash, but you're only charged interest on the portion of the money that you use.

- **Interest rates and repayments**

You only pay interest on the amount used. If you don't use the money you'll make no repayments. But you may have to pay a fee for having the facility. If you go over your limit or repay late, your interest rate may go up drastically or you'll have late payment fees added.

- **Security**

Can be secured or unsecured. Unsecured lines of credit tend to involve less cash and have higher interest rates.

Business lines of credit are often used for short-term finance. They can help you ride out seasonal lulls or cover unexpected costs. They're also handy for making purchases that are too large for a credit card but too small for a term loan.

Line of credit or business credit card?

A business credit card has the benefit of being useful for online purchases and ad hoc expenses, and keeping your business and personal spending separate. Some also offer an interest-free period, reward programmes, extended warranty insurance on purchases, and liability waiver insurance against misuse by other cardholders. As a bonus, they also allow you to track and categorise spending more easily.

However, they have higher interest rates and fees, and smaller credit limits than a line of credit, and they may require a personal guarantee which could affect your personal credit rating if payments are late. Protections and services may also be less than those offered with personal credit cards so it pays to check with the provider.

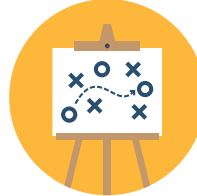
How to apply for a loan

Lenders ultimately want to know you'll repay them. Take your time preparing important documents, make sure you complete everything they require, and follow the instructions carefully.

To apply for a business loan, you will need:

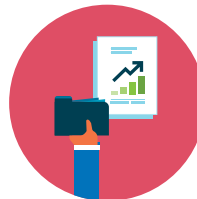
Business plan

Your business plan needs to explain the size of the opportunity and show how you'll take advantage of it. You should also show the lender specifically how the loan would be used. Key risks should be identified, with a plan for managing them.



Financials

Provide a budget showing how you'll afford repayments. If the loan is for an existing business, the lender will want two years of profit and loss reports and possibly tax returns. The budget should be realistic and based on sound assumptions.



Creditworthiness

Banks want to see that you have a good record of paying bills and debts. They'll check out your [credit rating or credit score](#) in business and possibly your personal life.



Security

Not all loans are secured but if you want to borrow a lot, you'll be expected to offer something in return. If you provide some form of security, the risk is that the bank can take it if you stop making repayments. If you offer a personal guarantee, the risk is that they may sue you if you can't repay the loan.



Lenders aren't especially concerned if your business becomes the next big thing. They don't have shares in it. They love a steady, predictable yield. So you don't need a wow factor to apply for a loan; you just need to demonstrate that you're a good solid bet.

How technology can speed up your application

It can be much simpler and faster to apply for loans if you use software to keep your business accounts. Here's why:

- **You can save time**

Sharing financial reports from your software means you don't need to print them off, fill them out, and share them manually with the lender.

- **You can get a decision sooner**

Giving the lender instant access to the financial reports allows them to assess your application faster.

- **Lenders will see a true representation of your business**

Accounting software makes it easier to keep your financial information up-to-date, so the lender can more clearly see how your business is tracking.

Types of lenders

The main types of lenders are:

- **traditional banks**
- **online and alternative business lenders**
- **peer-to-peer lenders**

Traditional banks

Banks come in many sizes – some are global, some national, while others are regional or community-based.

Because of their size, traditional banks often have the best business loan interest rates. They can also package a range of financial services for you. They might, for instance, combine a term loan and line of credit with deposit accounts and business insurance.

Banks aren't as speedy as some other lenders when it comes to processing and approving loans, but they're getting better. Some can make faster decisions if they have digital access to your financial records through [online accounting software](#) such as Xero.

Will they finance you?

Banks are more likely to approve a loan application if you have:

- provided a lot of the funding yourself (or can provide solid security)
- have prior industry experience or a business track record
- have a really credible business plan

It can be hard for startups to get big loans through a bank. Before putting the time into an application, speak with a bank manager, accountant or bookkeeper to see if your application will have a chance.

Online and alternative business lenders

Many online lenders focus solely on finance – they don't provide other types of services. Some specialise in certain industry sectors.

If you're a startup business, have a less than shining credit history, or no security, these lenders may be more approachable than banks.

They often focus on short-term and unsecured loans and frequently work faster than traditional banks. They accept online loan applications and may approve your loan within a day. On the flipside, their rates, fees and terms may not be as competitive as traditional banks. That's how they manage the risk of offering unsecured loans.

Peer-to-peer lenders

Peer-to-peer (P2P) lending platforms match people who want loans with people (or institutions) who are willing to fund them. The peer-to-peer platform oversees the application process, repayments and, if required, the security.

Application and approval processes are online and quite often faster than banks. You don't necessarily get all your funding from one person – multiple people might contribute.

The loans are usually fixed rate, short term and smaller than those offered by traditional banks. Interest rates can also be lower than at a traditional bank.





What's the right type of lender for you?

Don't go to the first lender you see. Make a list of potential lenders and compare them on things like:

- lending products offered (do they offer good term loan and credit deals?)
- interest rates, fees and early repayment penalties
- lending limits
- ability and authority to make lending decisions quickly
- friendliness toward small and/or local business
- what other services they offer that you might need (such as deposit accounts, international services, business insurance)

If you have personal bank accounts with a provider, consider approaching them. They can quickly see how you operate your personal accounts and this may work in your favour – providing you've been a good customer. If you have a mortgage with the bank, they can see what equity is available for you to use as security for business lending.

Talk to an accountant or business advisor about which lenders their clients have found to be supportive.

Get more tips on how to get a loan in the chapter on [pitching for business funding](#).

How to get a business loan

Lender pros and cons:

Traditional banks

Pros

Better interest rates

Package of business accounts

Cons

Slower application and approval
(although that is changing)

Less approachable for
startups and those with a
poor credit history

Online and alternative lenders

Friendlier to startups and
those with a poor credit history

Fast application and approval

New types of funding,
eg, merchant financing,
invoice financing

Higher interest rates
compared to banks

Shorter loan terms which
mean repayment is sooner

Some may require more
frequent repayments

Peer-to-peer lenders

Competitive rates

Fast application and approval

Friendlier to startups and those
with a poor credit history

Smaller loans than banks

Need to get fully funded
to get a loan

Your application happens
online and is public

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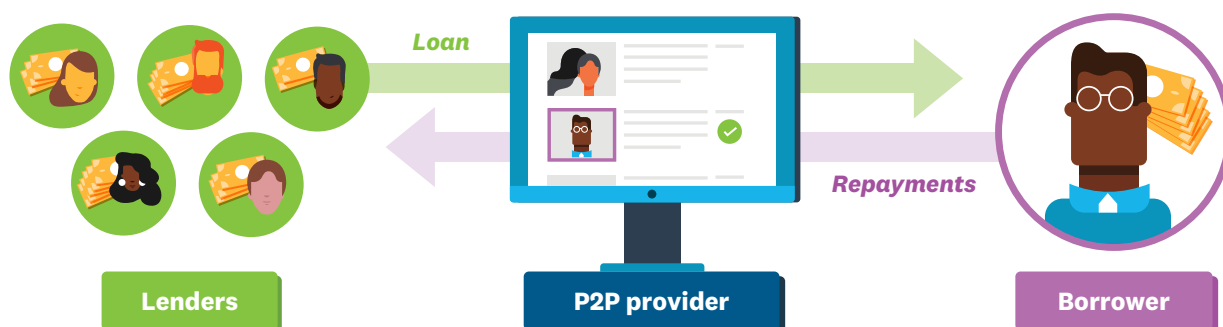
Peer-to-peer lending

Peer-to-peer (P2P) lending grew out of the 2007 global financial crisis, when traditional loans became difficult to get. So what are they, and how do you get one?

What is peer-to-peer lending?

With peer-to-peer lending you quite simply borrow from strangers. An online platform matches you up with people willing to lend. This is also called debt crowdfunding, crowdlending or marketplace lending.

At first, these platforms mainly provided personal loans, but this has expanded to business lending (sometimes called peer-to-business or P2B). Some major platforms have even developed partnerships with banks.



How does peer-to-peer lending work?

1. You complete an online application on the peer-to-peer lending platform website. Say why you need the loan, how much you need, and your preferred length of repayment.
2. The platform checks your application and determines your risk rating based on factors such as your creditworthiness, security and revenue projections. The platform sets the interest rates. (The interest rates can also be set by the lenders bidding for the lowest rate through a reverse auction.)
3. If approved, your loan request is loaded to the platform for interested lenders to browse and decide how much they want to lend to you based on your risk rating and the interest rates.
4. If a rate looks good, you accept offers from one or more lenders. Or, if no one is interested, the platform removes your listing.
5. The platform acts as the middleman for transferring the funds and co-ordinating repayments and any security.

Why people choose P2P lending

As the service is offered online, these lending platforms operate more cheaply than traditional banks. This allows them to offer competitive interest rates.

Lenders are attracted by the ability to earn higher returns than they'd get with bank savings or term deposit accounts. And they can protect themselves by spreading their lending across multiple borrowers.

Borrowers are attracted by greater accessibility, faster application processes, and competitive interest rates. Peer-to-business lending platforms may be a better bet for newer businesses who don't have a credit or cash flow history, those with low credit ratings, and unusual or innovative loan requests.

The lending platform makes its money through fees paid by both parties.

Society One is a local P2P lending platform.

Pros and cons of peer-to-peer lending

Pros

Rates are competitive

Application and approval are fast

It's friendlier to young businesses with little security and those without a long credit history

Early repayment is not always penalised

Approval criteria vary between platforms so your application could be approved by one when declined by another

Cons

For the best rate, you need a good credit rating and security

Loans are smaller than from banks

If your loan request isn't 100% funded, you don't get any money

Missing repayments can hurt your credit rating and result in large penalty fees

Only term loans are on offer, not lines of credit

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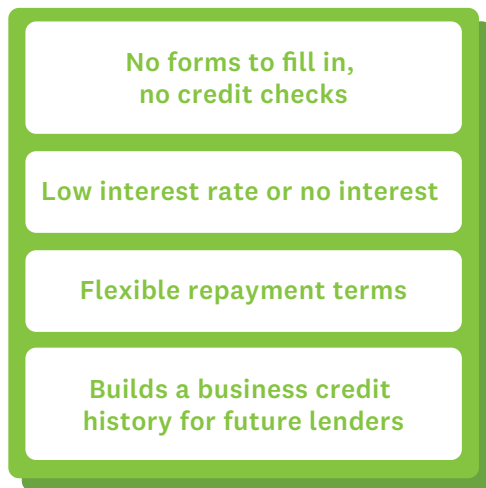
***Friends and
family loans***

Friends and family loans

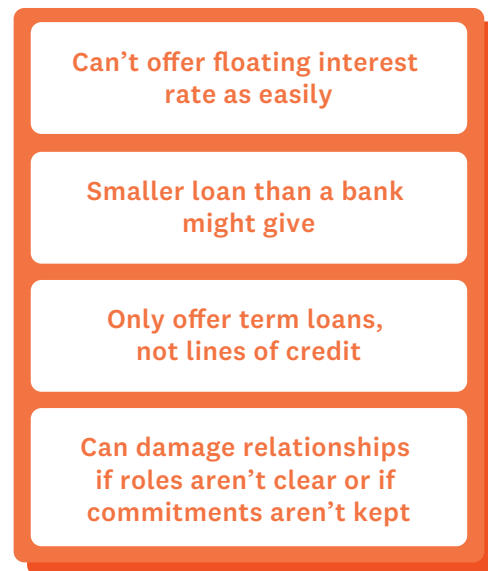
The bank of mum and dad has helped launch many a business. It's often available when other types of finance aren't. You just need to take a few extra precautions.

Pros and cons of family and friends loans

Pros



Cons



Friends and family loans can work

Without the good old family loan we wouldn't have companies such as Walmart, Motown Records, GoPro, or Amazon. And without a loan from Mrs Dyson, her husband would never have had the funds to develop his first cyclonic vacuum cleaner in the late 1970s.

How to borrow responsibly from family and friends

There's nothing wrong with starting a business with a family loan or one from a friend. No one knows you better. Plus they'll often give you better, more flexible lending terms. For instance, they may not require any security, they won't charge you an application fee, their interest rates might be lower (or zero!), and they might let you skip a couple of payments.

But there are some guidelines you should follow to prevent turning those friends into courtroom litigants, or being cut out of the will.

Pitch as you would to a bank or investor

Keep it professional but friendly. Show them why it's a good idea to lend you money for your business.

- Don't expect them to stump up every cent – explain what you're putting in and what you'll be taking out.
- Be clear with them about how much you need and why.
- Take them through your budget so they can see you intend to spend their money wisely.
- Be open and transparent, and manage their expectations – explain the risks and show them best and worst case scenarios.
- Make sure they understand they can't get their money back quickly if a family emergency comes up.
- Show them how and when you plan to repay them.

Loan, investment, or gift?

This can be one of the biggest misunderstandings when taking money from family or friends. Make sure all parties know what the situation is – especially other family members who might think you're about to blow their inheritance on a pipe dream.

- **Investment vs loan**

A loan might be better if you don't want your friend or family member telling you what to do. Learn more about the difference between an investment in your business and a loan in the chapter on [debt vs equity finance](#).

- **Loan vs gift**

If you're not paying interest or making repayments, the tax office could hit the person lending you the money with tax or penalties. Be aware of the rules.

Put it in writing

Create a formal record of the agreement. It will help you avoid misunderstandings at the outset, and it can be used to resolve disputes.

If it's a loan, document the following:

- the amount borrowed
- the interest rate (if applicable)
- the length of the loan including start date and final repayment date
- repayment terms – regular amounts or a lump sum when the business reaches a certain stage; whether early repayment is okay
- security (if applicable)
- penalties for late or non-payment – for example, increasing the interest rate, changing the loan terms, adding extra costs to the loan, taking of security, or instigating court action

For extra peace of mind, get a lawyer or accountant to take a look. To help get you started, check out our loan agreement template on the next page.

If it's an investment, the agreement will be far more complex. The document will need to say how many shares the investor gets and whether or not they have a say in business decisions. It should also explain if they're going to be held responsible for business debts or lawsuits. Definitely get a lawyer and accountant involved in writing one of these.

Always follow through

Do what you said you'll do. And give the lender a heads-up if things aren't going the way you hoped. You don't want them hearing from third cousin Bob.

- Make your repayments on time. If they can see the money coming back to them they won't begrudge it when they see you spending some money on yourself.
- Give them a report at year end – how the business is doing, how much you've repaid, any obstacles you might be facing.
- Be professional and treat them with respect. A successful relationship with a friend-or-family lender can be good evidence to put in front of a professional lender further down the track.

Loan agreement template:

Loan agreement

What it's for

- I, Jill Anderson, have borrowed • \$13,000 from Lois Anderson to help
- buy a front-end loader for my landscaping business, Earth Sculptor.

Amount borrowed

Start date

Length of loan

Finish date

Interest rate (if charged)

- The loan will start on • 13 March 2019, with a fixed interest rate of
- 3% per year. I have • 5 years to repay, finishing on • 13 March 2024.

Repayment terms (monthly or quarterly is common)

- Monthly repayments: \$234.

Security: There isn't any security on this loan.

What happens if payments are missed

- Early repayment: There won't be any fees or penalties for early repayment.
- Missed monthly payment: There won't be any penalties for a missed payment.
- If paid late: Any amount not repaid by 13 March 2024 will be subject to a 10% per year interest rate until it is all repaid.

Dated signatures

Signed:

• 

Lois Anderson
25 February 2019

• 

Jill Anderson
25 February 2019

5.3

Invoice financing

Invoice financing

Ever thought your cash flow would be better if everyone just paid what they owed you? Well, you may not have to wait – you may be able to get an advance on your unpaid invoices.

An alternative to traditional loans

Businesses that are getting low on cash can take out a working capital loan, but many find it hard to go through the process of applying and waiting for approval. It could be faster and more flexible to use invoice financing. This option works well for businesses that invoice customers and are owed money by them.

There are many forms of invoice financing, but the two most common are invoice factoring and invoice discounting.

What is invoice factoring?

Instead of waiting on customers to pay your invoices, you can take the invoices to a factoring company. Here's how it works:



Business owner



Customer



Finance company

1.

Invoice your customers as usual



2.

Sell invoices to the finance company (the factor)



3.

The factor advances you around 80% of the value of the invoices



4.

Customers pay the factor when their invoice is due



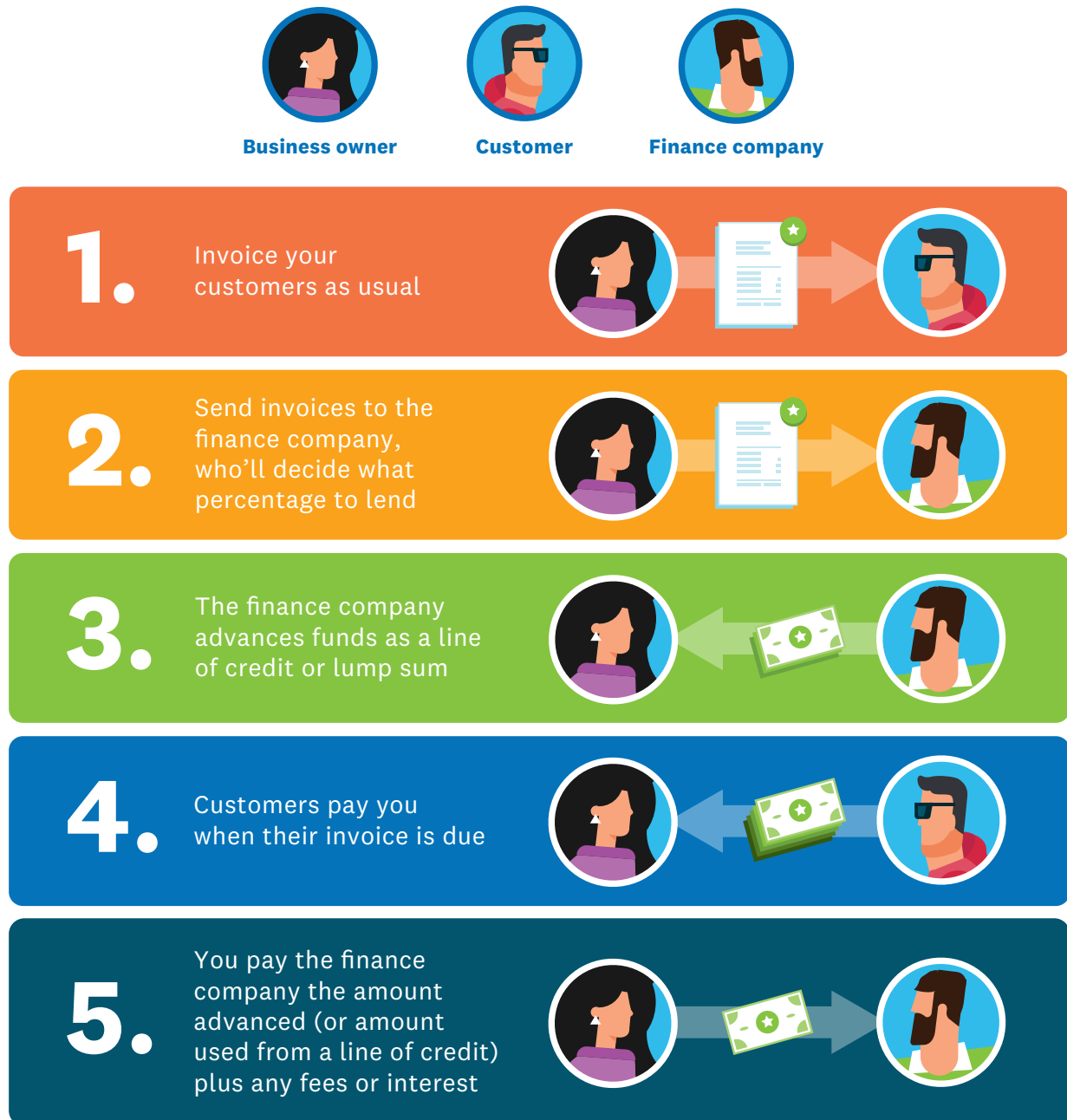
5.

The factor sends you the remaining money, less their fees



What is invoice discounting?

Invoice discounting is another way to generate instant cash from your invoices. But with discounting, you retain ownership of the invoices. Here's how it works:



When selecting an invoice financing provider, ask what happens if the customer doesn't pay. In some cases the finance company may take the hit. In others, it may fall to you.

Faster invoice financing

Invoice financing can be processed online using your invoicing or accounting software. You flag the invoices you'd like to finance and the provider assesses the application in a couple of days (or even a few hours).

These online services will also send automatic updates to your accounting software with details of part payments and fees on each invoice.

Pros

You get fast access to working capital as invoices are paid straight away

With factoring, accounts receivable can be handed over to someone else to manage while you focus on other things

There are no fixed term repayments to affect your cash flow

The invoices act as security so your loan history and credit score aren't a barrier to getting funding

Cons

You don't receive 100% value of your invoices

The actions of the finance company might damage your relationship with your client if the client sees them as your debt collector

You can become too reliant on invoice factoring rather than fixing the real issues causing your cash flow problems

They won't buy really old invoices

What is cash flow financing?

Cash flow financing is similar to invoice financing. But instead of selling invoices, the business gets a loan backed by its expected cash flow.

This allows a business that's reliant on cash to get funds immediately to meet needs it wouldn't normally be able to afford. For instance, a party supply store might have the opportunity to buy a bulk load of balloons at a discount price – but it must pay cash immediately. It usually wouldn't have enough cash to do this until the 15th of the month when a couple of big party planner customers make regular purchases. It gets a short-term cash flow loan to cover the balloon purchase, then repays it when the cash comes in.



***How to find
investors***

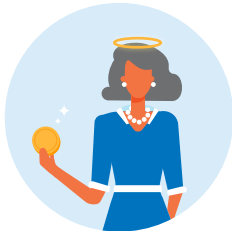
Instead of going into debt, you could sell a part of your business to raise cash. This is called equity financing. Let's look at the types of investors, what they want from your business, and where to find them.

Types of investors

Equity financing has become more popular in recent times, due largely to the growth in tech industries. Banks were less willing to take a risk on these types of startups but private equity investors could see the potential, put their money in, and were richly rewarded. It gave rise to a bigger investment community.

The easing of investment restrictions has opened up opportunities for ordinary people to invest in a business.

The main sources of equity financing are:



Angel investors

Wealthy individuals who invest their own money in exchange for a share of the business. They generally want to be involved in business decisions and may want to cash out after a few years. It will help if you can present a profitable exit strategy for them. An angel investor might be someone who wants to invest in your industry, or your community.



Equity crowdfunding

A platform where you can raise funds from the public in exchange for unlisted shares (equity) in the business. This is generally for consumer products or services (not B2B) and you'll do better if there's a wow factor to what your business is planning to do.



Venture capital (VC) firms

Professional investment companies that invest their clients' money in exchange for a substantial share of the business. VCs prefer to invest in companies that they expect to deliver massive and preferably fast growth.



Friends and family

Those loved ones who support your dreams with their own money. Many budding business owners turn here as a first option – or as a last resort.



Business incubators and accelerators

Development schemes to build and boost small businesses. Some will focus on a specific industry, and there's often a tech focus. Accelerators are more likely than incubators to have seed money to invest as they're focused on scaling a business they see has potential, rather than innovation.

Are you ready for equity financing?

Equity financing isn't an option for every type of business. It's not suitable for sole traders. If you want to sell shares, you'll need to be a company (although you can sell an interest in a partnership). So you need to have the right business structure before you head down this route.

How big is the pie?

Having a lot of shareholders might put off larger investors in the future. So consider carefully how many investors you want to take on board. Think about how you want to structure any deal alongside the debt funding you already have or might take on in future.

Know your worth

Know the value of your business – get a professional business valuation done. Then you know what you're swapping or selling in exchange for funding.

Get advice

Before you commit to seeking funding this way, talk to a lawyer and accountant about the legal and financial implications of equity financing. Research and understand any current and upcoming regulations and laws you'll need to comply with.

Where to find equity financing

Your first step to finding equity funding is to check what types are legal in your market. For instance, equity crowdfunding platforms aren't permitted in all countries. In the US, UK, Australia and New Zealand equity crowdfunding is allowed.

Central and local government websites should have information about registered venture capital and crowdfunding platforms and any regulation requirements.

Other places to check are:

- **Business incubators and accelerators**

They may have seed money (to help to start a business) to invest and they have access to angel investors.

- **Small business and industry associations**

They may have information about equity funders their members have had success with.

- **Your accountant or bookkeeper**

They may have other clients who've been successful getting equity funding. Or they may have clients looking to be angel investors.

- **Your bank**

They might be able to put you in touch with equity funders or venture capital firms.

- **Friends and family**

They may be more patient about getting a return and not want to exit the business as quickly. Or they may know other people wanting to invest.

What makes a good investor for your business?

If there's ever a time to look a gift horse in the mouth, it's when you're considering investors for your business.

While it can be tempting to shout an emphatic "yes, please!" at someone offering you money, stop yourself. Not all investors are created equal. Before you get yourself saddled with someone incompatible here are some qualities to look for. Ideally, they'll be:

- local – so you have access to them, and they don't forget about you
- in your industry – so you can draw on their experience, enthusiasm and contacts
- connected – so they can introduce you to the right people
- committed – so they're with you for the long haul

The right investor can offer more than just their cash. They can share their experience and connect you with the right people to help your business grow. For example, they might introduce you to new customers, great suppliers, lawyers, accountants, bankers, other investors, business advisors, or contacts in the media.

What does an investor want to know about your business?

Investors want to know you'll make money for them. They're not out to steal your ideas. That said, make sure you file any necessary patents, trademarks and copyright paperwork before you start working with them, just to be sure.

It helps to understand what makes an investor tick. When you know what they want from you, you can present a far more compelling pitch. They want:

- **Growth potential**

They're taking a bigger risk than a bank and so they expect fatter rewards. They want to back businesses that they think could explode.

- **Involvement in the business**

Most want to protect their investment by personally helping the business grow. They'll need assurance that you'll listen to and act on their advice.

- **Dividends or climbing share value**

They're investing to get a return. That can come as a dividend (profits shared among shareholders) or as an increase in the value of the business (so they could potentially sell their shares). You need to show them you'll be able to deliver one of those things. And be aware that to help them eventually cash in their shareholding, you may also need to sell yours!

- **Personal investment**

If you're not prepared to put any of your money into the business, why would they be attracted to invest? You'll need to put up a good portion of the funds.

- **Your exit plan**

Let them know if you want to build the business quickly and flip it. Or if you're in for the long haul. There's nothing wrong with either strategy. But your investors will want to know your intentions.

How can you impress potential investors?

Show you want to make money with them and for them – not just take it from them.

What's your plan?

Show them a solid business plan and demonstrate sound financial thinking. They want to see that you can grow fast, and have a plan for delivering good returns and increasing the value of the company.

What's their plan?

Talk about their plans too. Where do they see the business going and how involved do they want to be?

Be thorough

Take the time to prepare the necessary documents and complete everything they require. Send them your prepared documents ahead of meetings so they have time to review them.

Check how you look online

If your company has an online presence, be aware potential investors may look you up to find out more. Is there anything you wouldn't want them to see? Can your social media work in your favour and show the potential for growth through your fans and customers?

Being competent with your pitch is a good sign that you'll be competent running a business.

Check out our chapter on [building a funding pitch](#).

Are you looking for an angel?

Relatively few businesses can attract investment through VCs, crowdfunding, or accelerators. If you can't either, then you probably need an angel. Our next chapter looks at them in more detail.

6.1

Angel investors vs venture capitalists

If you've ever read anything about startup businesses that have hit the big time, you may have seen angel investors and venture capitalists (VCs) mentioned. Here's a quick guide to what they are and how they differ from each other.

What are angel investors and venture capitalists?

At a simple level, angel investors invest their own money while venture capitalists invest other people's money. They're both sources of equity funding in that they invest in return for a share in the business.



What is an angel investor?

What are they?

They're people who invest their own money in exchange for a share of your business, but often also provide mentorship and advice. While some invest on their own, there are also groups – flocks – of angel investors who get together to invest in businesses.

Who are they?

They don't have to be rich philanthropists with deep pockets – although that's a bonus. They can be successful business people, who've been where you are, and can see the opportunities within your business. They might be experts in your industry or just people passionate about what you're trying to achieve.

When do you want them to appear?

Angel investors usually come into your business at an early stage to help it get off the ground or take the next step after you've launched.

Where do you find them?

Angel investors are often found through good networking. Talk to others in your industry, your accountant, lawyer or business advisor, business development groups – even your customers. That guy who bought new bulldozer tracks from you yesterday might be the one with the golden pockets.

Why do they get involved?

They're not doing this for love alone – they're investing to make a return. They might be patient and willing to invest long-term but many of them like to cash out after a few years and that may involve selling the business. Be sure this is the type of funding you want before you find yourself saying goodbye to a chunk of your dream.



What is a venture capitalist?

What are they?

They're professional investors using other people's money (and maybe some of their own) to take a share in your business. They generally take a much bigger share than an angel investor. They're looking for well managed businesses with a competitive advantage, that look like they could quickly grow enormously. As a result, it's not easy to get them onboard.

Who are they?

They're hard-core investors so be sure you're ready for what they expect from you and where they want to take your business. Do your homework on them before approaching to make sure your business fits with their interests and when and how they like to invest. Your business is probably just one of many they're investing in.

When do you want them to appear?

Venture capitalists (VCs) tend to come in at a slightly later stage than angel investors – once your business is ready to scale up and really take off.

Where do you find them?

Venture capitalists might find you if your business has been successful – and especially if you have an innovative product that promises to be a real money generator. While you can find them listed online, the best option is to get an introduction through an angel investor, business advisor, lawyer, accountant, or other industry source.

Why do they get involved?

VCs want to be actively involved in the business. They may join the board and will want some say in the direction you're taking. Ideally, they want to see your business become a public company. They're all about making a substantial return on their investment. They're putting other people's money into it, after all. And they could be investing millions of dollars.

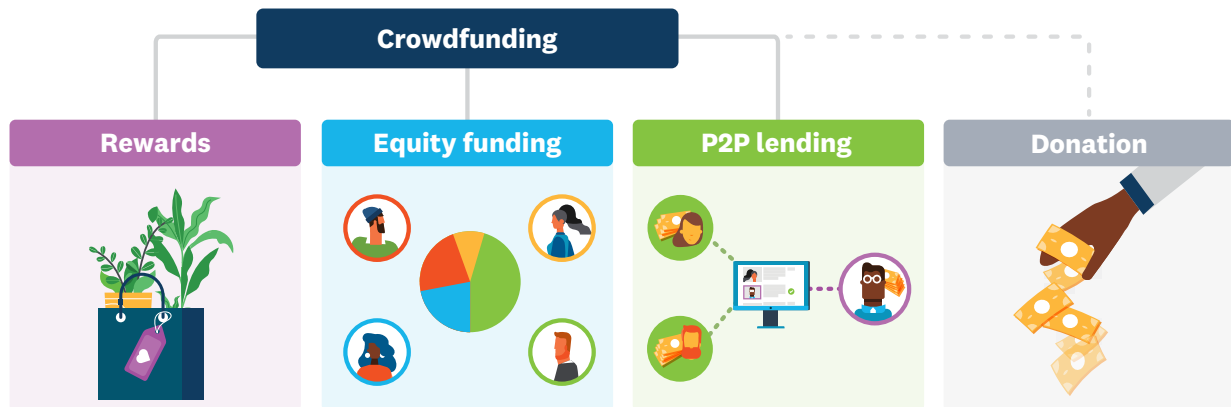
How to get angels and VCs onboard

Read our chapter on [pitching for business funding](#) to get an idea of the information you'll need to share with an angel investor or venture capitalist.

6.2

How crowdfunding works

Crowdfunding can get you the money to build a business, and the attention to build a customer base. It offers debt, equity, and presale options. Here are the basics.



What is crowdfunding?

At a basic level, crowdfunding is lots of people – the crowd – putting in money to support a project. It could be for something as diverse as a trip to a sports competition or to raise money for a bigger taco truck.

There are four different types of crowdfunding and three of them are relevant to small businesses raising finance. They can be especially useful for those who can't (or don't want to) get funds through traditional sources.

Rewards-based crowdfunding

With this method, people give an online contribution in return for a reward. The rewards may differ depending on how much is given – but often include the product or service you're planning to launch. For some people, this has taken over from going to family and friends to get a project off the ground.

Startups often reward backers with discounts, products, and services. For instance, if the project was a new board game, high-value pledgers might get a copy of the game while lower-value pledgers might get a discount when it's released.

Rewards-based crowdfunding is great for startups that want to test the market. If their idea fails to attract funds it's a pretty good sign they'll fail to attract customers. It's also a good funding source for businesses with really innovative products or loyal customer bases. It's easy to build on the enthusiasm of customers to get the funds they need.

The big names in social crowdfunding are:

- Kickstarter and Pozible (rewards)
- Indiegogo and OzCrowd (rewards/donations)
- GoFundMe and JustGiving (donations)

Equity crowdfunding

This form of crowdfunding lets you raise funds from the public in exchange for unlisted shares (equity) in the business. Unlisted shares aren't listed or bought or sold on an official stock exchange.

An alternative to giving investors shares is to offer them a convertible note. In this case, the investor lends the business money with the expectation they can convert the debt to shares in future. This method is often used when the business is a startup and its value has still to be figured out.

Equity crowdfunding is better for raising larger amounts than you could get through rewards-based crowdfunding. Because of the large amounts at stake, equity crowdfunding platforms – often called portals – are government regulated. There are rules around how much can be raised, how much can be invested, and how often you use them.

Equity crowdfunding platforms are registered with and regulated by [ASIC](#) (Australian Securities and Investments Commission).

How crowdfunding works

Peer-to-peer lending

Sometimes called debt crowdfunding, peer-to-peer lending works in a similar way to a term loan from a bank. But instead of getting the money from an institution, you get the money from individual people. You can learn more in the chapter on [peer-to-peer lending](#).

Four steps to start your own crowdfunding campaign

Got a project you need funds for? Or a plan to expand your business? Perhaps it's time to turn that taco truck into a fleet of trucks.

1. Select your platform

Start by choosing between a rewards or equity-based platform. Find out how long the different platforms allow campaigns to run. That can be important. What's the limit on how much you can raise? And find out who will see it. Certain platforms might attract different types of backers.

2. Get accepted by the platform

Fill in the online forms and provide any documentation they need. The platforms need to check you're legitimate. An offer document or prospectus may be required if you're looking to use an equity crowdfunder. This sets out the details of the investment, any prescribed risk warnings, and cooling-off periods for investors.

3. Make your pitch

Once accepted by the platform, you have a place to make your pitch. Describe your project or idea, why you want funds, and how much you're hoping to raise. If it's a rewards-based platform, list what backers will get. For an equity-based platform you'll need to state what the equity stake is and the share price – if it can be determined.

The pitch phase can require a lot of work. It's a full-on marketing campaign to promote your project or business and make it attractive to investors. And it may involve frequent updates to keep the interest going. Your business needs to use its customers and fans on social media channels to get the word out.

With an equity crowdfunding campaign you'll need to share your business and financial information with complete strangers. That includes up-to-date company information, financial statements and forecasts, a credible business plan, and – if you're an existing business – a realistic valuation.

4. Campaign end

With some social crowdfunding platforms you get all the donations raised during the campaign. With others, you have to set a target and only get the cash if you reach it.

With equity crowdfunding, you're given a time frame to attract investors. If you're successful, the platform arranges the payment of the funds to you and issues share certificates or convertible notes to the investors. If you don't attract investors, you may be able to extend the deadline.

These platforms make their money through fees – for instance a percentage of the amount raised plus transaction fees. Some also take equity. Some won't charge a fee unless you're successful. They're doing a lot of the administration and, in the case of equity platforms, they're handling the legal compliance that can be complex to do on your own.



Did you know one of the earliest crowdfunding campaigns was for the Statue of Liberty?

The French government gave the Lady with the Lamp to the American people but they were left to raise money for the pedestal to put her on. Joseph Pulitzer, the publisher, launched a fundraising campaign in 1885 through his newspaper, the New York World. In just five months, US\$101,091 was raised from over 160,000 donors.

How crowdfunding works

Pros and cons of rewards-based crowdfunding

Pros

You can test ideas and get feedback

You don't have to provide security or prove creditworthiness

You keep ownership and equity

You build a customer base and awareness

It's a debt-free way to raise funds

You can get lots of publicity

Cons

People can steal your ideas

If you don't reach the target, you may not get anything

It doesn't work for complex projects or B2B

You have to deliver rewards or potentially damage your brand

It's not ideal for raising large amounts

You're competing for attention so you have to stand out

Pros and cons of equity-based funding

Pros

It's possible to raise larger amounts quickly

It saves time approaching investors one by one

You can use the funds on growth rather than debt repayment

You retain company control, unlike with a venture capitalist who may want a board position

You increase brand loyalty as owners become advocates

The crowdfunding platform streamlines the process and handles compliance

Cons

If you bring on too many small investors, it can put off large investors later

Everyone knows if you fail to raise funds

You have to deliver dividends and increase the value for investors

You have to give up equity

There are limits on how often you can crowdfund

You have to spend time keeping investors up to date



Small business grants

Small business grants



Grants are a great funding option for some small businesses. They can be a lot of work to apply for but if you get free money at the end, putting the time in could be worth it.

What is a small business grant?

A grant is money that's given to your business by government, a company or a philanthropist. Grants are essentially free money – you don't have to pay them

back. Their aim is to give small businesses a helping hand. They're often targeted at job creation, projects that traditional lenders don't support, and on increasing economic benefits for communities.

Pros and cons of small business grants

Pros

Free money – no repayments

Feel good factor –
doing good with the money

Lots of grants available

Targeted at businesses
not supported elsewhere

May come with free publicity

Cons

Very specific eligibility

Time consuming to apply
and wait for approval

Can have strings attached

Competition for them is high

Who gets them?

Competition for grants is high – everybody wants free financing. You'll see a lot of them are for non-profits, but keep looking, there are plenty for businesses too.

Small business grants tend to be aimed at certain regions or sectors, specific types of businesses or causes, or particular community groups.

- startups
- women
- veterans
- minorities and under-represented groups
- regions
- industries
- causes (such as the environment)

How big are grants?

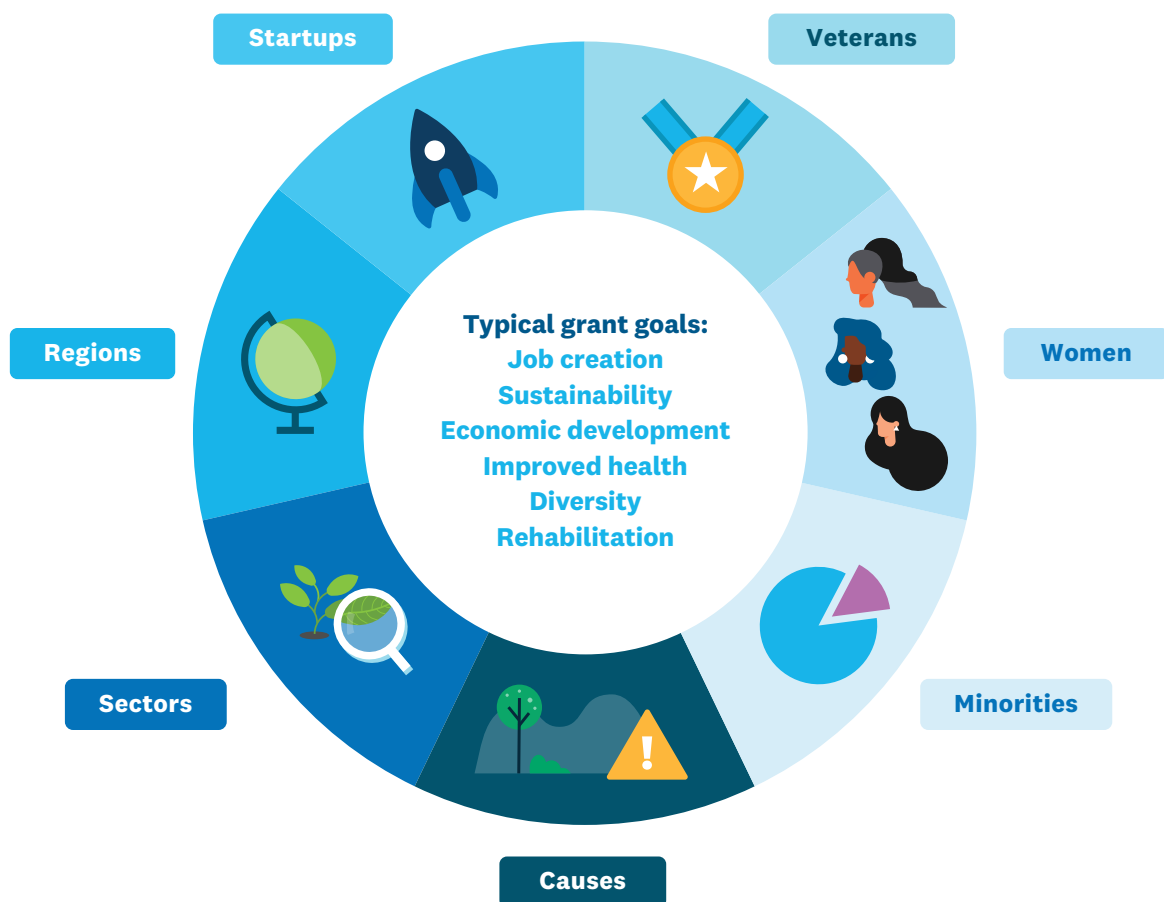
Grants can go from as small as a few hundred dollars to as large as hundreds of thousands. Most, however, are less than 10K. For that reason, they're often a supplement to other types of small business funding.

How do you find them?

Grants can come from every level of government, philanthropists, or companies.

Here's where to check:

- Government websites – central and local government. They should have a list of their grants and links to other sources like non-profits, foundations and corporations. For more information, visit the [Australian government page on grants](#).
- Small business and industry associations. They may have their own grants or information about grants their members have had success with.
- Your accountant or bookkeeper. They may have other clients who've been successful getting grants.



Are there startup business grants?

There are grants for startups but they're not going to fund your whole business. They might cover the costs of getting professional advice to create a business or financial plan, specific training, or investment in equipment. They're aimed at getting your foot on the ladder – it's still up to you to climb it.

Grants for research and development (R&D) are more plentiful, especially for innovative products and processes. These grants can help you plan, develop, test and refine your idea. They may take you through several stages but ultimately you'll have to find the final funds to go to market with your concept.

What strings are attached with grants?

Grants can be targeted and have restrictions. The money might only be able to be spent on specific things, or in certain places. For example:

- you might have to do some type of orientation or training before you can access the funds
- they might have a time limit, such as having to do your R&D within 12 months
- you may need to put up an equivalent amount or combine it with additional funding
- you may have to justify what you've done with the grant, or share results if, for example, you used the money for R&D

How to apply for a small business grant

The money might be free but you'll need to show why you deserve it.

Don't rush it

Be prepared to put in some serious time on the application. So read up about what's required from you before you commit. Check the time frame: how long will it take to apply and get an answer? Can you wait that long or is another source of funding a better idea?

Tailor your application

Do your homework as to why the grant was created and its purpose. Your application should show how your business fits the aims of the grant and how the grant will help your business – and make a wider difference if that is an objective.

Be thorough

Expect to provide information on yourself as well as your product or service, your market demographics, and how you plan to spend the grant. This may involve charts, graphs, and budgets. Know the strengths of your business so you can impress. Your business plan should have most of the information you need.

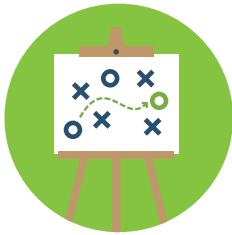
8

***Pitching for
business funding***

Seeking business funding is a major step but you needn't be daunted. Here's how to help lenders and investors understand your business and decide whether to take the risk with you.

What to demonstrate in your pitch

Whether you're approaching a bank for a loan or trying to convince someone to invest in your business, there are some basics to get down.



Show you have a plan



Share detailed financials



Convince them you know your stuff



Get them excited

On the one hand, you want to sell the dream. But you also need to demonstrate that you're sensible and cool-headed. It's a balancing act. Get advice from other business owners and an accountant or bookkeeper – they frequently prepare finance applications and know what works.

1. Show you have a plan

There are dozens of approaches to writing a business plan (we cover two in our guide on [how to start a business](#)). But the most important things to communicate to a financier are:

- the opportunity – explain the need you're fulfilling and estimate the size of the market
- market analysis – present some research that proves the opportunity is real
- how you'll resource the business – identify the skills you'll need versus the skills you already have
- your business model – demonstrate how you'll turn the opportunity into money
- financial forecasts and budgets – show when you'll be profitable

It's also important to talk about the long-term future, and your role in it. Are you staying in the business for the long haul? Or do you want to grow it and sell it on? There's no right or wrong answer – but investors and lenders will want to know your intentions.

2. Share detailed financials

Show financiers you've thought of everything – the good, the bad and the ugly:

- Your budget needs to be thorough and should include allowances for unexpected costs (contingencies) so they can see you're well prepared.
- Be specific about how you plan to spend the funding.
- Show your workings on high-cost items. Is there a cheaper alternative and, if so, why didn't you go with it?
- Don't be too ambitious with your sales forecasts. Include a best and worst-case scenario but base your budget somewhere in the middle.
- If the business has assets (or owes money), create a balance sheet. Lenders and investors want to see what value already exists, and if you've put your own money into it.
- Show how and when your business is going to be profitable.
- Give details of how much you intend to take from the business as a salary or wage, and if you've got another source of funds in reserve.

Show how they'll make money with you

You need to show the financiers what's in it for them:

- Show lenders how repayments fit in your budget (and don't forget to account for interest).
- Show investors when they can expect dividends (or an increased share price).

Buying a business?

If the funds are for buying a business, then you should also provide:

- two years of the business's profit and loss statements
- sale and purchase agreement
- turnover warranty – a statement of the business's guaranteed turnover during a defined period
- any restraints of trade which prevent the previous owner setting up in competition or contacting customers for a period of time

Expanding a business?

If the funds are to help you expand a business, then you should also provide:

- two years of profit and loss statements
- tax returns for the same period
- an explanation of how the funds will make the business more profitable

3. Convince them you know your stuff

You need to show you understand the industry you're entering. That goes without saying. But you must also give lenders and investors confidence that you understand the financial side of your proposal. It helps to know some (or all) of these numbers off the top of your head:

- Revenue – the money you'll generate from sales of your product or service over a specific period (normally a year)

- Costs, which come in two main varieties:
 - Direct costs – costs that go up the more sales you make (includes things like inventory).
 - Indirect costs – costs that stay the same no matter how busy you are (includes things like rent and staff).
- Gross profit – the amount of money your business will make from sales after deducting the cost of goods or services sold (and before you pay operating costs, payroll, tax and overheads)
- Net profit – the total amount of profit your business will make after deducting all costs (including direct costs, operating costs, payroll, tax and overheads)
- Margin – the difference between your product or service's selling price and the cost of production
- Value of security – the value of the assets you'll use to secure the lending
- Credit score – an external rating of how good you are at paying your bills and debts
- Repayments or payback on the finance you're seeking – what repayments you'll make and when, or what dividends you hope to pay out to investors and how much you'll grow the value of the company and their shares

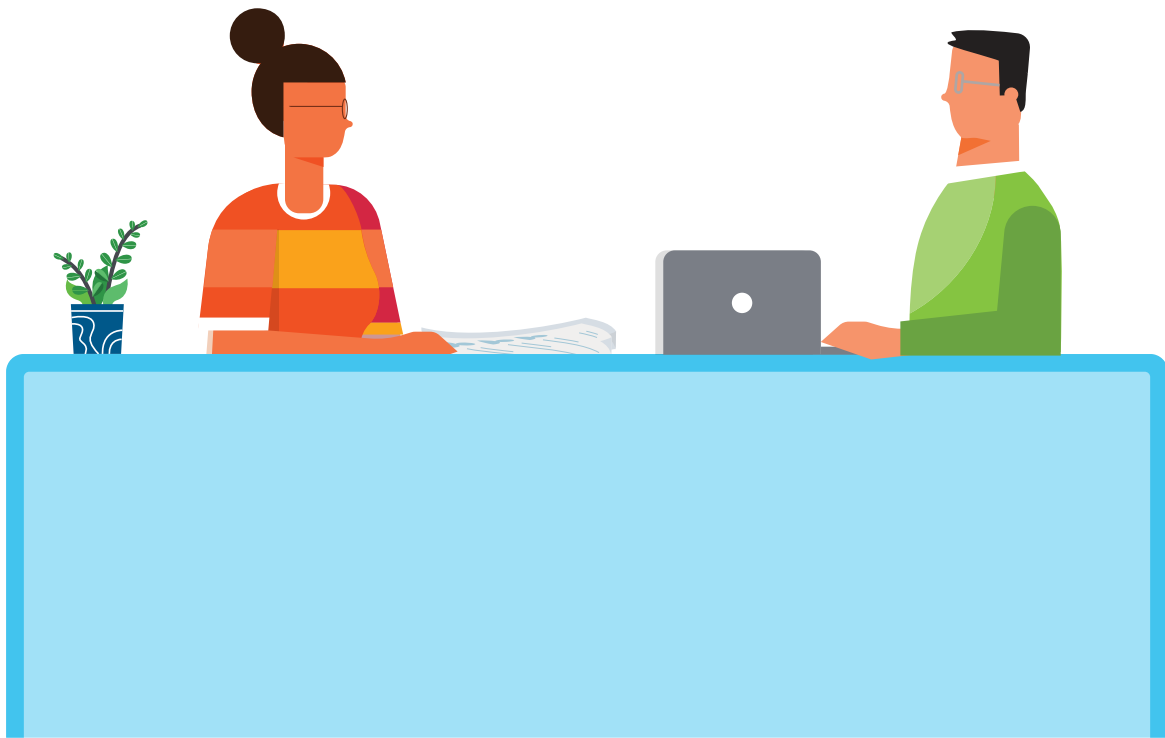
4. Get them excited

Don't forget to show them your product or service! If it's not created yet, show them a mockup. Make a video, take photos, show screenshots. Lenders and investors want to see something tangible. Don't leave it all to their imagination.

Show your belief in the idea when you pitch it, but don't lose sight of reality. While it's great to be excited about the financial potential of your business, you need to assure your audience that you understand the risks and threats. It'll be even better if you have strategies for addressing them. And if there's anything you don't know, be upfront about that too.



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