No-Nonsense Guide
to Finance for High Growth and Innovative Businesses

Business planning • Finding the right adviser • Bank debt
Venture capital • Funding innovation and commercialising IP
AIM and PLUS • Angel Finance • Invoice and asset-based finance
Sale and leaseback • Managing investor relations • Grants and business support

Business Link

Contents

This guide is divided into five parts:

1. PREPARATION
Before you approach anyone for funding, you will need to work out where your business is, where you want it to go, and how much you need to take it there

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A look at the various types of finance available and how to secure them

3. AFTER THE EVENT
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For more on all these issues, visit the Business Link website at:
www.businesslink.gov.uk/growth

Welcome

The right finance is key to delivering high growth and backing innovation, but securing it can be a challenge. This online guide has primarily been prepared with small and medium businesses in mind, to help your quest for funds by providing you with a better understanding of:

- Assessing your specific funding needs
- Where and how to get the right advice
- Various funding options
- Pitching to and dealing with investors

Drawing on the experiences of businesses like yours and advice from industry experts, this guide aims to provide practical business advice. Based on a review of the previous No-Nonsense guide for High Growth Companies, this publication has been created to reflect the economic climate of 2009 and the specific needs of innovative companies. Furthermore, with Business Link, the government-backed business support service, at the helm, there is no product sell or bias – just objective guidance on what's available in the marketplace.

This guide is only a starting point. We hope that, as a result of using it, you feel better positioned to access the support you require. Should you need to talk to someone, our Business Link advisers will be only too pleased to help. To find your local Business Link, call **0845 600 9 006** or visit **www.businesslink.gov.uk**

Finally, if you are a new or early-stage business looking to raise small amounts or start-up funds, you may be interested in our No-Nonsense Guide to Small Business Funding, also available online, on **www.businesslink.gov.uk**


image: iStock

Introduction

To drive innovation and rapid growth in your business, you need clear, jargon-free advice on securing the necessary financial support

When you're looking for funding to take your business to the next level – whether that's to accommodate expansion, or develop a new idea (see the Route to Market box, opposite) – you need sound advice to help you decide on the appropriate source of finance, and how to go about securing it. This regularly updated online guide contains the information you need to start the process, with the key contacts and links to enable you to find out more.

The importance of innovation

You don't have to be the most innovative of companies to achieve rapid growth, but you must have a service or product that excites people enough to keep them buying from you.

Innovation means creating something new or delivering a product or service in a way that has not been done before. Companies that can do this are able to gain a competitive edge and generate more customer interest.

Such businesses play a key role in supporting the UK economy. In March 2008, the Government published the Innovation Nation white paper, which set out the need to foster innovation among small and medium-sized enterprises in order to raise productivity, encourage competitive businesses, meet the challenges of globalisation and operate within the UK's environmental and demographic limits.

However, developing an innovative product and service can take a lot of time, during which suppliers and staff have to be paid. Funding is an essential part of innovative and high-growth businesses, and the Government is keen for such companies to get access to both the money and support services they need.

FOUNDATIONS FOR GROWTH

The Government took two significant steps towards creating a climate that fosters innovation and entrepreneurship when it commissioned the Gower Review into intellectual property, which was published in 2005, and Lord Sainsbury's report into science and innovation, which came out during 2007. The findings of these reports have clearly shown that innovation in business is essential to the future success of the UK economy.

Today, as we come to terms with the economic effects of the global downturn, the importance of investing in innovation, in preparation for the eventual upturn, now appears all the more necessary.

Support for innovative businesses

As you can see from the Route to Market box opposite, innovative companies have many hurdles to overcome if they are to be successful. However, there are many organisations, some backed by government such as the Regional Development Agencies and Business Link, and others in the private sector that will support companies seeking funding and investment.

Simplifying government support
In the past, there were more than 3,000 government-funded business support schemes available to companies, which businesses owners found confusing. To make it easier for companies looking for funding, the Government has introduced Solutions for Business, a streamlined portfolio of around 30 government-funded support products. By March 2010, these are the only products that businesses will see. For more information, visit **www.businesslink.gov.uk/solutions**

Understanding the opportunities
Finding the right funding is about identifying the exact needs of your business at its particular stage of growth, and tying your business plan in with an appropriate type of investment. Some businesses need more cashflow, especially in today's tough economic times. Others require a large single investment, even if it has to be exchanged in return for a share in the business.

Whatever your requirements, you should be aware of your options and what's available. If you have a good business case, there's probably a package that will meet your needs. This guide helps you decide on how much you require, the most appropriate type of funding and how to secure it, backed by case studies showing how companies at various stages of development have accessed finance. It also offers advice on what this will mean for your business going forward. ■

THE ROUTE TO MARKET: SOURCES OF FINANCE

STAGE 1 »
The business begins with just its intellectual property and a growth strategy. However, as an innovative company, it must persuade the established industry of its worth. A small management team with sector knowledge is recruited, a business plan written and seed funding accessed.

STAGE 2 »
The company uses the funding for early-stage trials and tests and develops a prototype. The successful prototype enables the company to get more funding, and it aims to get market ready.

STAGE 3 »
With "proof of concept" behind it, the business must find a route to market. This may be through licensing, or directly by the company itself. Discussions with partners, potential clients and suppliers are advanced, and the commercial value of the product can now be assessed. Angel investors or venture capitalists invest in business as they feel the company is close to full trading.

STAGE 4 »
As the business begins to grow, it's likely additional investment will be needed to fund areas such as manufacturing, sales and marketing, branding and additional staff. Further funding would be supported by venture capital, but business angels may also co-invest.

STAGE 5 »
The company has begun trading in the marketplace. However, it could be many months or years before it achieves an outright profit, and even when profitable it will have to overcome cash shortfalls. Money from sources such as invoice finance or further equity investment may be considered here.

Why do you want finance?

image:iStock

If organic growth is proving difficult, raising funds may be the best way to expand your business. Determine your needs and the right route for you

If your business needs a cash injection, should you go for a debt option – a bank loan, asset-based lending or invoice finance – or equity investment, where you trade shares for funding? By analysing what stage your business has reached and where you want to take it, the most appropriate way to fund growth should become clearer.

If you're seeking finance, your business has probably reached a critical point. For instance, a start-up technology company may need funding to pay wages and rent until its first product comes to market. Or perhaps, a consumer goods producer on the verge of securing its first contract to supply a multiple retailer, might need cash to expand production and distribution. Alternatively, a social enterprise may require funds to expand nationally, following local success, or, on an operational level, a business may need a cushion against cashflow fluctuations.

IN BRIEF THE RIGHT FUNDING

- Determine what you've achieved and where the company is now
- Ask yourself how appropriate your sector is for various types of finance
- Allow a time 'buffer' in case fundraising takes longer than expected
- Focus on the types of finance appropriate to your growth plan
- Seek specialist advice

Whatever the situation, it's vital to find the right funding. That means focusing on the finance options that not only align with your aims, but also your stage of development.

Debt and equity

Broadly speaking, you can raise money for your business either by incurring debt or selling equity. There are several fundraising solutions to consider within these two camps. Forms of debt go beyond the familiar concepts of borrowing, overdrafts and leasing, and include very specific solutions, such as invoice discounting. Whatever the debt arrangement, you are effectively purchasing money, usually by paying interest on credit extended to you, often on the basis of being able to provide sufficient security.

For equity finance, investors will want a stake in your company based on the sum on offer, measured against the value of your business. Rather than lending, the backer is buying into your business. They will make a return through dividends and, ultimately, the sale of shares. Investors tend to structure deals with an element of debt, too. This ensures some payback over the investment period, prior to eventually selling the stake.

Giving up a share of your business can be daunting. Fear of losing control, the expense, the timescale and worries over complex deals deter some businesses from using equity finance. But equity investors can improve your business' long-term prospects by offering key skills and expertise. In fact, the profile of equity investment has risen in some quarters in line with the lack of liquidity in the debt market, particularly among innovative businesses with potentially valuable intellectual property.

Operational issues

Businesses often choose debt finance to address an operational problem that may or may not be growth-related. For instance, cashflow fluctuations caused by seasonal factors, or late payment by customers are frequently smoothed over by an overdraft.

Alternatively, invoice discounting, where a lender will pay you when an invoice is raised (so you don't need to wait for the customer to pay), may help keep you in the black. If the aim is to preserve working capital, leasing rather than buying equipment can help, while larger one-off outlays can be met by a loan.

Funding growth

Debt-based solutions may be flexible, but there will be times when it's necessary to

CASE STUDY

After making initial equity investments, the founders of London-based Fairtrade hot drinks company Cafédirect managed to secure additional external funding for growth. This was achived through preference shares and shareholder loans, as former non-executive director Andy Redfern explains.

"A lack of assets meant we couldn't extend our overdraft or credit facilities. Concerned about the commercial nature of venture capital, we decided to raise money through a public share issue to invest in our brands, develop markets, repay debt, fund working capital and improve IT. We raised £5m in this way with sponsorship. Rather than being listed on a conventional stock market, buyers and sellers are linked up through a matched bargain system run by broker Brewer Dolphin."

12 QUESTIONS TO ASK YOURSELF

1. What are my business finances like? Lenders and investors are more likely to release the funding you are looking for if your finances are sound.
2. How much is my business spending and how much will the growth plan cost?
3. How much do I need to raise to fulfil my business objectives?
4. How much is it feasible to raise from the various possible sources?
5. What is the business worth?
6. What will finance cost in fees or equity?
7. How quickly do I need the money?
8. What factors affect the type of finance I can seek? For instance, your company's growth potential may be too low for a venture capitalist, or your sector may not interest investment houses on your list.
9. What contingency funds could I access, if fundraising takes longer than expected or if I fail to secure funding?
10. When does the backer need to be paid back, or when will I need to find an exit?
11. Will I be able to raise further funds?
12. Should I be looking for one lump sum, or staged payments over several years?

IN BRIEF BUSINESS INCUBATION

Many early-stage companies improve their chances of achieving rapid growth by joining a business incubator – or business innovation centre. This provides an environment where young companies can flourish, drawing on resources shared with other businesses, such as premises and management services.

Crucially, a good incubator will also offer advice on, and access to, funding by banks, business angels and venture capitalists specialising in early-stage companies. Some are privately run and established as businesses in their own rights, while others are sponsored, at least in part, by public sector agencies or universities.

There are also a number of incubators that began life as investors, and over time began to add a range of business services. Travelling in the opposite direction, a number of incubators began life as providers of business services, adding an investment capability at a later stage. Most incubators have premises, but some offer a virtual service.

Incubator programmes are not open to everyone. Typically, a company will have to apply and make a case for being given access to the facilities. Nor are they a permanent option. Designed to accelerate the growth of companies at an early stage, the expectation is that businesses will move out and establish their independence at an appropriate time. Statistics suggest that those that do enter an incubation programme have a better chance of success than those that initially go it alone.

For further information, visit Business Link at: www.businesslink.gov.uk

consider equity finance. In the early 2000s, debt was cheap and many businesses funded growth with a large amount of help from their banks.

However, in the wake of the sub prime mortgage crisis, credit may be more expensive and harder to find, with many lenders wary of backing ambitious growth plans, due to the level of risk. This has emphasised the importance of equity finance.

Rapid expansion from a turnover of £500,000 a year up to £10m, for example, may call for increasing production, opening an office overseas or employing a bigger sales team. You could, of course, fund this by borrowing against assets, but even if lenders are forthcoming, repayments will be a drain on the business.

Under these circumstances, equity investment can provide upfront cash without the burden of regular repayments. This means reducing your stake in the company, as the investor buys in, but if all goes to plan, the real value of your holding will grow.

It's also important to recognise that private investors can actively help you grow by giving advice and recommending executive and non-executive directors.

Equity finance

If you choose this route, you'll be working closely with your investors, so make sure that you get to know them first, because it's important that the chemistry is right.

Ideally, they should have the relevant experience and industry knowledge to help your company grow.

Equity finance can come from a number of sources. These include: so-called friends and family investors – essentially personal contacts, who have the money and inclination to back your plans, with anything from a few hundred to a few thousand pounds; business angels – individuals who specialise in supporting young, growing companies; and venture capitalists (VCs).

VCs will probably only be interested in investments of £250,000 or more, and will be looking for a flotation or trade sale within three to seven years to allow them to achieve a high return.

Social enterprises

Locating funding options that match your business objectives is particularly relevant for social enterprises looking to expand. Often they will find that the conventional sources of growth finance, such as venture capital or angel investors, are inappropriate, requiring them to go against their core values.

In this situation, a social enterprise should consider approaching a specialist lender, or look at an alternative public offering, which provides funding, while letting the business maintain its ethical stance.

Expert advice

Whoever you are dealing with, seek sound advice. While your accountant will undoubtedly help you in your relationship with lenders, dealing with equity investors requires more specialist help.

A legal adviser should check any deal, and when preparing to talk to VCs, you should enlist the help of a corporate finance specialist. Mid-tier accountancy practices with a national presence, are particularly strong in this area.

Advisers will also be able to help you establish whether you really need to raise finance or if your problems can be addressed in other ways. For instance, if cashflow is an issue, it may be possible to resolve the problem by raising invoices more quickly, or by taking a more proactive approach in chasing unpaid debts. There are always alternatives.

CASE STUDY When Essex-based technology company Lysanda developed a system to monitor and control vehicle emissions, the owners thought they were onto something big. But, as the original co-founder of the business, Simon Harris, recalls, there was no certainty that a market existed for the innovative product.

"For evidence of customer interest and how to get to market, we had to rely on a mixture of anecdote, hunch and assertion, as we didn't have the resources to explore these issues further by carrying out the necessary research.

"However, we received grant funding from the East of England Development Agency, which enabled us to hire a consultant to test the commercial potential of the product, which we called Eco Log.

"His report identified potential customers and partners. Thanks to this research, we are now marketing Eco Log."

Grants of up to £20,000 to assess marketing potential are now available from Regional Development Agencies through **Grant for Research and Development**, a Solutions for Business product. For further information, visit Business Link at: **www.businesslink.gov.uk**

For advice on calculating your investment needs, see pages 14-15 ▶

Where to go next

For help with choosing the right finance, visit: www.businesslink.gov.uk/financetype

Find the right finance solution

Finance option	Amount sought: £100k to £500k	£500k to £1m	£1m plus	Typical uses of finance	Time required to arrange	Typical charges, fees and interest rates
Bank loans	✔	◗	◗	New premises, rolling out chains, marketing, working capital, low-end acquisitions	1-3 months	Interest depends on lenders – can be more than 2-4% over base rate charged before downturn. Typical fee is 1.5%
Invoice finance	✔	✔	✔	Primarily a tool to maintain positive cashflow and provide working capital. Can finance less costly growth plans	1-4 weeks	Service charge 0.1-0.5% of turnover for invoice discounting, 0.75% to 2.5% for factoring. Daily Interest around 1-4% over base rate, has increased in downturn
Asset-based lending	✔	✔	✔	Provides working capital and finance for a variety of reasons including growth plans, refinancing, mergers and acquisitions	4-6 weeks	Interest of 1.75-2.5% above base rate, plus a lending fee of 0.5-1.5% of the loan
Leasing	✔	✔	✔	Can be used to acquire a range of assets to avoid paying out large sums upfront, freeing up working capital to fund less costly plans	1 month	Deposit of 5-30% and a finance fee of 1.25-10% above the base rate. Due diligence charge of 0.25-1% of total advanced
Angel finance	✔	◗	✘	Funding moderate to high-risk, high-growth plans, including product or service launches, marketing and techology development – typically post proof of concept	3-6 months, but could be up to 1 year	Legal and accountancy fees up to 5% of funds raised, capped around £10,000 – may be more for larger sums (presently less). Private investors will take equity for cash. Networks charge success fees of 5%
Venture capital	✘	◗	✔	Funding moderate to high-risk, high-growth plans, including funding acquisitions, product or service launches, new premises, national or global expansion	3 months to a year	Corporate finance fees of 5%*, plus 5% equity options. Legal costs up to £30,000. Accountancy fees. Around 20% or higher equity stake. Membership list no longer freely available
PLUS market	✘	✔	✔	Funding moderate to high-risk, high-growth plans, including funding acquisitions, product or service launches, new premises, national or global expansion	3 to 6 months, but could take longer	10-12%* of funds raised on average, including advisers' fees. Average flotation cost is £150,000, but can be as much as £200,000
Alternative Investment Market (AIM)	✘	✘	◗ Only if over £5m	Funding moderate to high-risk, high-growth plans, including funding acquisitions, product or service launches, new premises, national or global expansion	3-6 months, although preparation can take far longer	10.5%* of funds raised on average, including advisers' fees. Often as much as £300,000 to £400,000
Alternative public offering (APO)	✔	✔	✔	Funding moderate to high-risk, high-growth plans, including funding acquisitions, product or service launches, new premises, national or global expansion	6-12 months	10.5%* of funds raised on average, including advisers' fees. Often as much as £300,000 to £400,000

✔ Likely
◗ Possible
✗ Unlikely

	Pros	Cons	Social enterprises' chances of securing funding	Page no.
	Loans provide a means to finance growth without surrendering equity to a shareholder	Repayments can drain cashflow; you may need to put up security; costs have risen; may be harder to secure and rates may be higher	✔	20-23
	Depending on the lender's terms and conditions, you can receive up to 90% of the value of an invoice as soon as it is raised, providing capital	A trading record and £100,000 plus turnover may be needed, excluding smaller companies and start-ups. Factoring involves the lender chasing debts, which can unsettle customers	✔	24-25
	Loans can be secured against a wide range of items, plus intellectual property. Currently, banks may be more willing to lend on an asset-backed basis	The minimum sum may be too high for some small businesses. The lender effectively takes ownership of the assets, which are sold if the debt cannot be serviced	✔	26-27
	Very flexible, as almost anything can be leased; gives access to up-to-date equipment; offers tax benefits, as leasing costs are an allowable expense	You will not own your assets	✔	28-29
	Angels tend to be more prepared to back early-stage businesses; may offer contacts, advice and skills; less formal than venture capitalists	Angels can be hard to find; they will seek an exit, typically after three to five years, or sale on AIM/initial public offering; you will have to surrender equity dependent on the valuation of the company	✔ Although angels will have exit concerns	30-35
	Venture capitalists provide larger amounts than angels; offer expertise and access to top-class management; will usually have strong industry contacts	Venture capitalists expect rights over your business; will seek an exit in three to five years, meaning a sale, float or refinancing; will want a good deal on equity; will push hard on valuations in current financial climate	◗ Finding an exit strategy that gives investors a good return and keeps the core values of enterprise can add complexity to venture capital deals	36-41
	Cheaper than floating on AIM or the London Stock Exchange main list, but offers similar advantages, notably tradable shares that can be used to make acquisitions; profile and credibility; less regulation than other markets	Success depends on market sentiment and convincing investors about your company; only a limited pool of investors and liquidity (the buying and selling of shares) is restricted; communicating with shareholders takes time and effort; you will have to surrender equity	◗ Investors may be wary of backing social ventures in the current climate, unless there is a clear prospect of a return	42-43
	Profile and credibility; typically raises larger amounts than debt, angels or PLUS; you can raise more money through secondary issues; tradeable shares can be used to fund acquisitions	Many companies find there is little liquidity (the buying and selling of shares) in their shares; reporting to shareholders takes time and effort; you give up equity; better suited to medium-sized businesses; tough raising new money in current financial climate	◗ Investors may be wary of backing social ventures in the current climate, unless there is a clear prospect of a return	42-43
	Profile and credibility; offers more funds than debt and angels, but is still appropriate for small businesses; less regulated than official markets	Not appropriate to all business types; you have to create publicity and make the market yourself	✔ Allows social enterprises to raise funds, but doesn't open up the business to the full market pressures	42-43

* Typical amount – fees are negotiable

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Bring in the experts

The right advice is essential when raising funds. But where can you go for help?

Securing finance will be easier with key advisers on board, who will help the deal run more smoothly, and spot any funding barriers. For example, they will know if your business is going in the wrong direction, or if your management team is weak. They will also help identify alternative funding sources and have useful contacts.

Gaining funding will take you away from your day-to-day role in the business, with larger equity finance taking up to six months to complete. Professional advisers will guide you through this complex process, and the long-term benefits far outweigh their cost.

Finding the right advisers

Start with your local Business Link adviser, who will assess your needs, and suggest at least three options for each position sought. Also, ask friends and business contacts for recommendations, such as your accountant and bank manager, or go to professional bodies, like the Law Society.

Select experts who are right for you. Make a shortlist, then meet to discuss your business needs and examine their track record. You're looking for advisers who can not only help you gain finance, but who also understand your business. So you need to find out:

- What information and advice you will get
- How often you will meet and for how long
- If you will be able to call them in a crisis
- What areas they will cover
- What you will need to do yourself
- What results you can expect
- How they will charge you

Be clear about how much effort you are prepared to put into the relationship. To make the most of your meetings, ensure you have all the key details to hand. You'll also need to be prepared to act on their advice.

Once you have selected your team of experts, agree specific targets. Be honest

IN BRIEF EXPERTS

- Businesses that seek expert help build turnover faster than those that don't
- Accountants and lawyers are essential for raising finance. For equity finance and going public, you may also need a corporate finance adviser, a broker and a financial PR consultancy
- Build advisers' costs into funds sought

CASE STUDY

CCBT began to develop an innovative computer-based treatment for anxiety disorders, but needed investment along with an experienced management team to realise its commercial potential, explains finance director Tim O'Connell.

"We used the investment-readiness scheme run by Warwick Science Park's Investment Fund to commericialise the business plan, bring in an experienced team and secure funding. Our product, FearFighter, is now being used by one third of the UK's primary care trusts, and we're planning to expand overseas."

FURTHER POINTS TO THINK ABOUT

What to ask before you hire an adviser:

- What types of fundraising does the expert specialise in? Check their track record in your business sector
- Which lenders and investors do they work with? Are they impartial?
- How quickly can they secure you finance?
- How do they propose structuring fees?
- Can they supply three references, ideally in a similar business area?

You should also:

- Speak to one of the expert's recent clients to find out how they operate and what they did for them
- Think carefully about the fee structure, so that it provides the right motivation to allow you to get the most out of your relationship. One possible option would be to combine a retainer, a bonus for getting better terms and a closing fee

and communicative. Let them know if you are unhappy with anything, and check they feel you have stuck to your side of the deal.

Who should you consider?

Accountant: One of the first outside sources to consult, accountancy charges will depend on how much you raise (typically 1 per cent or more of larger sums) and the scope of the work. Otherwise expect an hourly rate of £200 to £400, or £175 to £300 outside London.

Legal adviser: You can't raise equity finance without a legal adviser. Fees for raising £500,000 in venture capital would typically range from £15,000 to £40,000, while a flotation will cost from £50,000 to £150,000.

Corporate finance adviser: Sitting between your business and potential lenders or investors, corporate finance advisers help to source and secure all types of finance at a higher level. Charges are usually made up of a series of fixed costs, a closing fee and bonus. Fees may reach 7 per cent for deals under £1m, but 2-6 per cent for larger deals.

NOMADs, brokers and corporate advisers: To list on the Alternative Investment Market (AIM), you'll need a nominated adviser (NOMAD) and broker to help you comply with the regulations. A PLUS market listing requires a corporate adviser. Expect to pay £100,000 to £400,000, plus 3-4 per cent of funds raised.

Financial PR adviser: Compulsory for a market listing, financial PRs charge from £2,000 to £5,000 a month.

High growth coaching: Coaches offer key advice on how to grow your businesses. Coaching for High Growth, a Solutions for Business product, delivered by Regional Development Agencies and accessed through Business Link, assigns coaches with experience at chief executive level. They work with companies with high growth potential to foster and develop management skills. Companies wishing to take part must make a case for inclusion. For more information, visit: www.businesslink.gov.uk/solutions

For advice on calculating your investment needs, see pages 14-15 ▶

Where to go next

For more on advisers go to
www.businesslink.co.uk/advisers

image: Shutterstock

Intellectual property

Protect your intellectual property and other intangible assets, as they may be important when you are looking for investment

If your business is innovative or creative, you will probably have developed some intellectual property (IP). The law allows you to protect the originality of your business, and you should take all the steps possible to ensure others can't steal your ideas. IP can also be a major advantage when searching for finance, as investors are looking for a concept that can't be copied easily. In fact, if you have not taken the necessary steps to safeguard your IP, few investors will want to risk their money by investing in your business.

Currently, businesses built on innovation and creativity have an advantage when looking for funding. They can be cheaper to set up and expand, and your competition has a harder job copying your good ideas. Often profit margins are higher than for labour-intensive businesses, and if you are successful, you can license your IP to other businesses or to manufacturers abroad.

IN BRIEF PROTECTING YOUR IP

- IP is not just a patent. Most original ideas can be protected in some way
- Protect your IP before looking for funding, or you may put off investors and risk your idea being stolen
- Be careful when using contractors. Make sure they assign the IP from their work to you and insist on non-disclosure

What intangible assets can be protected?

Usually for IP, only the three "registered rights" in UK Law are considered: patents, trade marks and design rights. They protect the innovative processes, the name and the design of your product or service.

But you also have unregistered assets, like copyright, know-how and confidentiality. These can be protected using contracts with staff, manufacturers and distributors. It is vital to be thorough in protecting your IP, and investors will ask what steps you have taken.

If you employ a company to improve your prototype, have a clear contract that ensures you own the rights to any improvements. If your product is a spin-off from education, or uses ideas from your previous job, you'll need to be clear about the ownership of all IP.

Where do I start?

Consider your IP from day one, and secure your rights as soon as possible. If you're unsure about the rights you own, audit them and take the necessary steps before applying for funding. Use The Intellectual Property Office's (IPO's) IP Healthcheck to print a report showing what action needs to be taken. Visit www.ipo.gov.uk for this and other useful IP information, including a list of relevant events. For further information from Business Link on how you can make the most of your intangible assets, visit www.businesslink.gov.uk

If you need an IP specialist lawyer, most will offer a free introductory meeting to discuss your needs. The Chartered Institute of Patent Attorneys (www.cipa.org.uk) and the Institute of Trade Mark Attorneys (www.itma.org.uk) can recommend one near you.

What are the costs?

A basic UK patent costs around £3,000 to £4,000, but global patents are far more expensive. Registered rights are charged for a period of time in a certain area. For example, registering a trade mark for 10 years costs £200. You need to protect your product wherever it is sold or made, especially in emerging economies, where it's cheaper to copy ideas. You'll also need to pay for expert advice if your concept is similar to others on the market. You may not be able to protect registered rights that are similar to your rival's IP, but can, for example, ensure the confidentiality of your know-how is safe.

What questions might investors ask?

Aim to show you're protected in two ways. First, prove your business can't be copied easily. The harder it is for rivals to enter your market, the more attractive your proposal. Second, show that your idea has licensing potential. You can use your IP as a source of profit, either making it available, or using contractors to manufacture your product for other markets. To do this, consider exactly what you need to protect in different markets, and include this in your business plan.

Pre-commercialisation funding?

If you have a bright idea, but need some help to commercialise it, funding is available from some Regional Development Agencies. The grant help that's available to businesses varies widely. For more information about grants, see pages 52-56.

If you are collaborating with a commercial partner to produce a prototype, draft agreements to protect your IP are available at www.ipo.gov.uk/research-ukip.htm ■

CASE STUDY

Unable to secure funding for his laptop security products business, Norman Shaw of ExactTrak, based in Oxford, met two intellectual property (IP) lawyers from Mathys & Squire, who explained that his problem was that he didn't hold patents on his invention.

"I was having a problem getting investors to take me seriously.

"Mathys & Squire worked with me to identify the innovative and unique steps that were the basis of three patent applications.

"With my IP protected, three venture capitalists offered funding for the next stage of development, and the first big orders are already coming in. My prototype also received government funding, and none of this would have happened without patent protection."

For advice on attracting equity investment, see pages 16-17 ▶

Where to go next

Visit www.ipo.gov.uk for guides, education and the free downloadable IP healthcheck for your business

Calculating what you need


image: iStock

Before seeking finance, it's important to know how much you require, your chances of securing it and which source best suits your needs

Financial backers expect you to have carefully considered your funding requirements, so that the amount and timing of borrowings has been rigorously assessed and there is a robust strategy in place to provide repayment – essentially, that your business is investment-ready.

How much should I ask for?

You need to cost each aspect of your growth strategy. For acquisitions, try to identify the potential target and its likely price. To launch a product or service, you'll need a marketing plan, which should include: who you will target; assumptions about how many sales or customers you hope to acquire; the proposed medium; and the cost of the campaign. Opening or purchasing new premises will require an assessment of the cost to buy or rent in the suggested location, as well as any proposed modifications. Other areas you may need to assess include: salary costs for staff you plan to recruit, the cost of the equipment required, or how much suppliers would charge for the new stock lines you propose to sell.

Rob Donaldson, head of M&A and private equity at advisory firm Baker Tilly, advises asking for slightly more than you need when raising finance. "The fixed costs can be high if you are looking to secure smaller amounts of money," he says. "So make sure you raise enough, as you don't want to do it twice."

You should also plan to include some breathing space for at least a year, as it's difficult to ask for more once a sum has been agreed, and extra funding could take several months to raise, potentially compromising operations.

"Company directors tend to take an optimistic view of prospects," says accountant Stephen Bayfield of PKF. "Investors gain confidence if a contingency plan is evident, as things rarely go to plan. Remember, sales are usually more unpredictable than costs."

Ultimately, you may need to temper your ambition. It's worth formulating alternative growth plans in case the financier offers you a smaller amount than you have asked for, to make sure you don't lose time trying to raise funds while your existing resources dwindle.

If your sector is unusual, new, or you're a social enterprise, the time taken to raise

IN BRIEF YOUR FUNDING NEEDS

- Research what level of funding your plans require, the risks versus your expected returns, and how the funds will be repaid
- Consider what affects your calculations, such as sector factors, track record, business strategy, the life stage of your company, existing financial resources and the value of your assets

growth capital will be further extended, and this should be built into your costs. You may also need to consult specialist lenders (see Banks and Specialist Lenders, pages 20-23).

What affects the amount I can seek?

Be realistic, given the stage of development your business has reached. For most companies, funding tends to rise incrementally from small amounts of secured debt and personal investment, to more sophisticated facilities, such as invoice finance and leasing, and business angel, venture capital and public market funding. When considering how much you can expect to secure, think about these two factors:

How financial institutions view your sector

- Your management team's track record
- Existing and potential future competitors, and the economic climate
- Your existing debt facilities
- Your asset backing – what assets can you use as security with investors or lenders?
- Your vision – it's important to have clearly defined goals and ambitions

What is the most cost-effective option?

Raising finance can be expensive in terms of time, and arrangement and advisory fees. For more on advisers' fees, go to pages 10-11.

If you are raising venture capital, you need to be aware of the costs involved. So if you're likely to need extra finance in the medium term, it's often more economical to seek more at the outset.

As most debt is secured, costs tend to be lower, although for cashflow loans a funder will require independent due diligence, which will be paid for by the borrower.

Cash outlay for angel investment tends to be minimal, but risk is usually compensated for by a higher equity stake. For information about angel and venture capital finance, go to pages 30-41.

CASE STUDY

Seatwave is a £30m London-based ticketing company which has gained backing from venture capitalists on three separate occasions. Chief finance operator Aksel van der Wal explains what you need to consider when looking for finance.

"Business owners need to think about not only what they want to achieve, but also how much of this is realistic. Once this has been done they can look at how much it will cost. Our growth was mostly viewed in terms of hiring new staff and marketing. Because of the way our payment model works, we don't have huge cashflow issues. However, ticketing is seasonal so that had to be taken into account when making forecasts."

For a listing on the Alternative Investment Market, most companies look to raise at least £5m, with the PLUS market typically used to generate slightly less. Listing costs may top £500,000 on AIM (less on PLUS), so consider carefully whether either market can meet your needs. The financial climate has seriously hit the stock markets, so flotation may not be the right move until the economy improves.

For advice on using bank debt for growth, see pages 20-23 ▶

Where to go next

For The Institute of Chartered Accountants in England & Wales, visit: www.icaew.com

Attracting equity investment

It's a battle securing investment from venture capitalists and business angels, so it's vital to make your proposal as attractive as possible

Under any circumstances, encouraging investors to trade finance for a stake in your business is tough, and currently it's harder than ever.

Only a fraction of the proposals venture capitalists (VCs) receive get as much as a phone call. Even fewer will go all the way and secure investment.

Today, risk is seen even more vividly, the flotation market is effectively closed, and investors have less to invest – there are simply fewer deals around. To stand a decent chance of success, you need a strong proposition, able management and rigorous preparation.

Getting investors' interest

Your proposition must show a carefully evaluated business idea detailing the risks and rewards. Emphasise how potential investors will benefit financially and the timing of their exit, if applicable. You should also include where your business sits in its chosen market and why it will succeed against existing and potential competition.

It's also very important to show an investor how your business will cope in a tougher trading environment, as well as explaining how you are going to take advantage when the recession subsides.

Ian Shields is a manager at g2i, which helps businesses prepare for funding. He says investors will be impressed by a business plan that understands the effect the recession is having on companies. "Identify how you're going to get through the downturn and take advantage when you come out the other end," he explains.

It's also important to know what the investor is looking for from a company, so assess the following:

- The backer's investment range
- The stage of business they typically finance
- Their geographical reach
- Their deal portfolio and sector preferences

If you're seeking angel finance, go to networking events to get an idea of who you're up against. For more on **business angels**, see **pages 30-35**.

Your management team

Investors need to be able to believe in and work with your management team. They are likely to be looking for:

Personal qualities: Illustrate your business pedigree by highlighting past successes

Contacts: Prove you have good contacts in your chosen sector

Commitment: Show that you believe in your business enough to invest some of your own money in it, and that you're prepared to put in

IN BRIEF SECURING EQUITY INVESTMENT

- Match your proposition to investors' requirements
- Investors consider track record, the quality of the management team, contacts and financial commitment
- Work out what returns you can offer
- Decide how much equity and control of your business you would be prepared to share


image: iStock

maximum effort. Social enterprises may find it difficult to secure investment that requires security, as directors are unlikely to want to offer personal guarantees. Therefore, social enterprises should explore all alternative security sources before approaching an investor

Team: Emphasise your directors' previous experience in their role and at a similar level

Track record: Push your past experience. If you've been through tough times, it's vital to explain the lessons you've learned

The returns you can offer

An investor's main concern is the potential return and when they'll see it. They typically seek businesses offering an early exit, by trade sale or flotation (for more on exit strategies, see pages 36-41), and will want to know:

- Is the proposition feasible?
- Can the management deliver the plan?
- Are the potential rewards enough?
- How will I get my money out?
- If the business is to be sold who will buy it or how will the market react to flotation?

What are best and worst-case returns?

By attracting equity investment you are growing your business, and although you will have a smaller stake, it will potentially be worth significantly more.

Remember that equity investors in social enterprises will not necessarily be looking at a conventional exit strategy, but may still want a return on their investment.

CASE STUDY

Richard Williams is chief executive of Hampshire bio-detection company Stratophase, which has attracted £3.6m of finance from investors, including Boston-based East Hill Management.

"You've got to pitch your business plan according to what your investor is looking for," he says. "We are developing devices that can detect fatal viruses without the need of a laboratory. They could be useful in medical settings, but because of the nature of that industry, they could take years to produce, which could have put off potential investors.

"To avoid this, we adopted a low-risk model, using the technology to develop products for military, agricultural and manufacturing environments before moving into the medical sphere."

Also, treat rejection as a chance to improve your offering. Ask for feedback and try to fill gaps in your proposal.

The ability of VCs to raise funds has been adversely affected by the ecomomic downturn, and this has resulted in many investors having less money to re-invest in businesses.

For advice on what to include in your business plan, see pages 18-19 ▶

Where to go next

For more on equity finance, visit: www.businesslink.gov.uk/equity

Visit the British Venture Capital Association at: www.bvca.co.uk

A business plan to raise finance

Securing funding isn't easy during a recession, so getting your business plan spot on is essential if you are to convince investors

image: iStock

To acquire the funds you need to grow, your business plan should be tailored to your finance provider. A potential backer wants to see why you need finance, how you plan to use it, how they will get their money back or realise a return on their investment, and the evidence that backs up any claims you are making.

If you have an inexperienced management team, which has never dealt with raising finance before, you should consult an adviser, who can help you prepare the right business plan.

The structure of your plan

Executive summary: Your overall vision; a mission statement; plans; the current state of the business; details on your product or service; your value, proposition

IN BRIEF BUSINESS PLANS

- Include background information on the business, market analysis, future opportunities, existing operations, brief management biographies, SWOT analysis, forecasts and existing finances
- Try to keep it under 40 pages and tailor it to the type of finance sought – 10 pages may be enough to secure debt
- Keep the look and feel straightforward

and growth strategy; unique selling points (USPs); sales; forecasts

History and background: The business; its origins; historical performance; sales data

The market: Size; growth rate; major players; your position; technical advances; forecasts; relevant government regulations

Opportunities: Vision and objectives; customers and their needs; target market; product or service positioning and value offering; USPs (such as plans to cut prices); patents or other legal protection; pricing; distribution channels; marketing plans

Operations: Financial; organisational and human resources; requirements not yet met

Management team: Brief background of your key people; their responsibilities and relevant skills; gaps that need to be filled

SWOT analysis: Strengths; weaknesses; opportunities; threats. Be thorough here, to avoid investors spotting weaknesses and threats that you have not identified

Financial forecasts: Sales; gross margin; logic behind figures; profit and loss account; balance sheet and cashflow three-year forecasts; payback period; breakeven point

Financing: Loans and debt arrangements; a breakdown of how funds will be used

Exit routes: Possible exit strategies – for more on this, see the box on page 41

This covers most forms of fundraising, although securing debt requires less detail, with added emphasis on assets, security, creditworthiness and aged-debtor analysis – who owes you what and from when.

A business plan for a social enterprise will also need a clear explanation of what the social enterprise is and your social objectives. It should show that the company has a strong track record, is able to repay any borrowing, and, if relevant, generate sufficient profit to interest a social investor.

To read and download a sample plan, visit www.businesslink.gov.uk/businessplan

How much to include

Each section should be between two and four pages, with slight variations depending on the type of business – a manufacturing company, for example, might talk more about its products' intricacies. Avoid over-emphasising any one section, and only use headline figures in the executive summary.

"Knowing what to leave out is as important as knowing what to include," says Jane Khedair, managing director of Business Plan Services. "An effective business plan is more than just a set of spreadsheets, but the narrative shouldn't be a novel. It needs to have sufficient detail to present the relevant facts and whet readers' appetites."

Empathise with your audience

- Backers want to be confident that the interest and capital repayments can be met. Talk about how risk can be controlled, loss can be limited, and security. Adjust the tone to suit the audience
- Invoice and asset-based financiers are less concerned with security than the quality of your debtor book, credit management capabilities, bad debt record and the extent to which the business suffers credit notes. They may also want to have an idea of the sell-on value of your assets. For more on asset-based lending, go to pages 26-27
- For equity investors, focus on market opportunities and exit options, such as trade buyers. Venture capitalists are having a tough time, as currently the market for flotations is effectively shut, while investors are more cautious. This makes floating unlikely, but if you're not exiting for three years, it can be discussed

Focus on the present

While projections are vital to backers, don't forget existing sales, customers and the make-up of your management team. "People buy people, not business plans," says Khedair. "Business ideas remain conjecture without the right people to implement them."

Keep a straightforward look and tone

Lengthy plans are off-putting, says Khedair. "An executive summary should be just that – a summarised version of the main areas of the plan," she stresses. "Restrict it to two sides, letting the rest of the plan provide the detail."

Presentation is everything. Keep the plan's language and appearance clear and accessible. Use photos and graphics if relevant, but don't overcrowd it. Supply the plan as a professionally presented document.

Seek advice, but an adviser shouldn't write the plan without your input. It should reflect your character, because investors are backing you as much as your idea.

For advice on negotiating with investors, see pages 46-48 ▶

Where to go next

For more on business plans in general, visit: www.businesslink.gov.uk/planforgrowth

For more on business plans tailored to equity investors, visit www.bvca.co.uk

Banks and specialist lenders

The credit crunch has made it difficult to secure funding from lenders, but there is still money out there. So how can you raise it and is it right for your business?

Getting a loan from a lender may be a little tougher than usual at the moment, but despite all the furore surrounding the credit crunch, cash is still available for businesses and entrepreneurs.

Are the banks still lending?

Banks are still providing finance, but it may be more difficult to secure than before. The interest rates banks are charging are likely to be higher, because they are assessing risk in light of the economic situation. At a time when many well-known businesses have suffered, successful growing and viable companies are finding it hard to get funding.

A key problem is that banks aren't lending to each other as much as before, leading to a slowdown in credit for everyone. As a result, banks need to borrow money from institutions they may not have used previously, such as the European Investment Bank (EIB). The EIB doesn't lend directly to small businesses, but lends through local banks. Several UK banks already take EIB loans to support their small business clients. So if you are applying for a bank loan, make sure your bank manager is aware of the **EIB's lending packages**, as it may help you get a cheaper loan. For more details on these, visit: **www.eib.org**

Enterprise Finance Guarantee

In response to the serious problems caused by the credit crunch and demand from small businesses, the Government has intervened with a scheme to encourage bank lending to businesses. The Government had previously supported bank finance for businesses through the Small Firms Loan Guarantee (SFLG). This has currently been replaced with the **Enterprise Finance Guarantee (EFG)**, a Solutions for Business product.

Under EFG the Government will guarantee lending to viable businesses. The scheme means the Government is providing £1bn of guarantees for £1.3bn of lending to small businesses. There are several lenders on board, offering loans of between £1,000 and £1m for a period of three months to 10 years. Visit **www.berr.gov.uk** for a list of the lenders involved. To qualify, you must be a UK business with a turnover of up to £25m, and have no obvious access to finance.

The guarantee can be used to support new loans, refinance current ones, or convert part or all of an existing overdraft into a loan to release capacity in order to meet working capital requirements. Under current government plans,

IN BRIEF KEY ASPECTS OF BANK DEBT

- Good for buying assets and medium-paced expansion
- Raising between £1,000 and £1m plus is possible
- Assets and track record of the management are key
- You may have to make personal guarantees, such as putting your house up as security
- It has become tougher to secure since the credit crunch


image: iStock

the scheme will be available up to 31 March 2010.

For more information on the EFG, together with other ways the Government is helping small businesses, visit: www.businesslink.gov.uk/realhelp

Should I get a loan?

If your business needs a significant injection of cash, you may have no choice other than applying for a loan. The only real alternative is to sell shares in your business. However, you must be aware that equity is often the most expensive form of funding in the long term, since you are exchanging part of your business in return for cash. Also, as a result of the credit crunch, your company is likely to receive a lower valuation than previously.

If you do take a loan, you will have repayments scheduled from the outset. This means new businesses looking to launch products or services without sufficient cashflow to service the loan may not be considered. However, your bank may offer a capital interest holiday (or repayment holiday) from the start or allow you to make lump sum repayments. Regardless of the exact nature of the deal, the bank will want to know the following details about your business before they will be willing to lend:

- The track record and financial position of your business and the management team
- The loan's purpose and your ability to repay
- The value of your personal guarantees

Banks generally ask for security on the loan in the form of a personal guarantee. If you don't have the necessary funds, banks will usually ask for your home as security.

What are the costs?

Bank loans are cheaper to raise than equity, but pose more of a cashflow burden. Always check the annual percentage rate (APR) for interest on any loan. It is worth shopping around. Get a written quotation first, and read the small print, looking for hidden charges. In general, costs include:

- Interest, which is usually 2.75-4 per cent over the base rate, although it may be higher for new businesses and deals can

BANK DEBT

PROS

- It is cheaper and easier to obtain than equity finance
- You do not have to give up any control of your business to a backer

CONS

- Businesses with little trading history may find larger loans hard to obtain
- Defaulting on repayments or breaching conditions may mean paying back in full

CASE STUDY

Hi Ho Silver, based in Somerset, is a multi-million pound jewellery business which has been financed solely through overdraft loans. However, until director Emma Warren joined the business, it had only been able to get limited finance from the bank, and so its ability for growth was being inhibited.

To change this, Warren set about improving the quality of information the business produced. This took the form of formal management accounts that could show a lender exactly what the money it was investing in the business was going to achieve.

"Part of my brief was to get management accounts in order and to establish a relationship with the bank. This makes a huge difference. If your bank has proper management information which is presented monthly, and you inform them about the decisions that you are making, then it makes it a lot easier for them to support you."

vary. Interest is charged on the amount of the facility you use at one time, and is levied quarterly or monthly
- A lending fee with arrangement costs of 1-1.5 per cent of the loan can be charged
- A prepayment fee may be levied if you decide to pay the loan back early
- Charges are based on the level of risk and your standing

How quickly can a loan be secured?

It can take between one and three months to finalise the detail, but you should get an initial answer within weeks. Getting quotes from a few banks can force a quicker decision.

What is the loan dependent on?

Banks have a strict underwriting process and set the following provisos before a loan can be agreed:

- You have to sign legally binding covenants, and if you breach the conditions, the bank will be entitled to immediate full repayment
- Your profits should demonstrate an ability to service the debt
- Monthly management accounts and audited annual accounts are required to be presented before and possibly throughout the period of the loan
- Lenders may want to see how you manage debt, with analysis of how much the business is owed alongside when the invoice was issued (this is called aged-debtor analysis)

Getting the best deal

Take the time to shop around – it could save you money in the long term. Make sure you negotiate with the bank manager to get the best deal, and ask if you can have any special terms in writing.

Use a financial broker to propose the best deals for the type of finance that your business needs. A broker can save you time and money, and can also increase your chances of getting a loan by presenting your proposal in the best way to the most appropriate lenders. But don't forget to establish what fees, if any, the broker will charge you.

You will be able to find a list of financial brokers by visiting the National Association of Commercial Financial Brokers' website at www.nacfb.org.

Research the small print. Apart from interest rates, assess other lending criteria, such as loan terms and set-up fees. Consider having an expert, such as a solicitor, review the loan documents.

Negotiating the terms of your loan

A loan agreement can be a long and complex document. How you agree the terms of the loan will have a direct impact on the health of your business. Remember that almost everything will be up for negotiation.

Aside from discussing basic issues, such as the due date of the loan and the interest rate, you also need to establish the amount of the loan fees. It's important to make sure that you will have the flexibility to pay off your loan earlier than the due date and, if possible, try to avoid any penalty for early settlement.

Negotiate for a grace period for your payment schedule and check to make sure that late payment charges are practicable.

ALTERNATIVE SPECIALIST LENDERS

Not all businesses fit into the same type of model, and as a result, have difficulty getting finance from traditional lenders. If your business has a social, charitable or ethical dimension, then you could try the sources below:

Name	Website
Adventure Capital Fund	www.adventurecapitalfund.org.uk
Big Issue Invest	www.biginvest.co.uk
Charity Bank	www.charitybank.org
Futurebuilders England	www.futurebuilders-england.org.uk
Triodos Bank	www.triodos.co.uk
Unity Trust Bank	www.unity.co.uk
Co-operative & Community Finance	www.icof.co.uk

The alternatives to the high-street banks

Big institutions typically use a computer to give loan decisions, and if your sector is unusual or you run a social enterprise then it may not fit the model.

Briefing the bank on your market can help, but if you are rejected there are alternative lenders that specialise in particular sectors, as well as in helping businesses that have failed to get funding elsewhere.

While specialist lenders often operate in areas that the main ones won't consider, they still examine the same criteria.

"We look at a number of factors, including business background and history, and what experience the management team has," explains Sue Cooper, deputy head of business banking at Triodos Bank.

However, specialist lenders can be more flexible in the way that they look at other aspects of the business, particularly personal guarantees.

"We work with the usual types of security (property, etc), but don't take personal guarantees," says Cooper. "We can work with security from a community of guarantors, where risk is split between them." ■

For advice on calculating your investment needs, see pages 14-15 ▶

Where to go next

For more details on bank debt visit: www.businesslink.gov.uk/bankdebt

For more information on the banking sector in general, go to The British Bankers' Association's website: www.bba.org.uk

Borrowing against your invoices

Raising funds against the value of your invoices can dramatically improve your cashflow, but is debt factoring or invoice discounting right for you?

Invoice finance comes in two forms: factoring and invoice discounting. For both, cash is advanced to you when you raise an invoice. The lender pays an agreed percentage of each invoice, with the balance, minus fees, paid on settlement. The difference between the two is that factoring includes sales ledger and collection management.

Invoice finance is only suitable for partnerships and companies selling goods or services on credit to other businesses.

The benefits of invoice finance

Getting invoices paid upfront helps maintain cashflow, which could help to keep you afloat in a recession. Invoice finance is a cost-effective alternative to overdrafts or bank loans, and there is often no need for extra security before the money is advanced.

However, they'll want to see sound management processes and, for invoice discounting, an efficient credit control system. Invoice finance lenders will consider most sectors, but some companies are less suitable, such as those that allow the return of goods or take cash payments.

IN BRIEF INVOICE FINANCING

- Immediate advances of as much as 90 per cent of the invoice
- Retail and cash businesses are less appropriate than manufacturers, distributors and service providers
- Can help to even out cashflow
- The charge is a one-off percentage of turnover, plus interest on the amounts borrowed

How much can I raise?

Typically, lenders advance 80-90 per cent of invoice value, depending on the quality of the debt. If your customers are deemed creditworthy, you'll get a higher percentage.

What are the costs?

For factoring, costs usually range between 1-3 per cent of turnover, whereas invoice discounters usually charge between 0.1-1 per cent. The factoring charge depends on how much work is involved in the collection of the ledger. Some invoice financers may insist on a minimum level of turnover for a minimum fee. The second cost element is the interest charged on what you are borrowing, which can range from 1.5-3 per cent above the base rate.

An optional cost to consider is bad debt insurance. With a 'recourse' facility, if your clients don't pay within a specified period (usually 90 days), the lender will reclaim the money from you. By opting for a 'without recourse' service, you'll be covered for up to 100 per cent of the invoice value on the default of the debtor.

How quickly can I get a deal?

It can take from a week to a month to get an answer, depending on the size and complexity of your business. Lenders will want to:

- Examine your business and its accounts
- Carry out some due diligence, including scrutinising your sales ledger history and your credit control procedures

image: iStock

- Perhaps suggest changes to your processes, before the facility is cleared

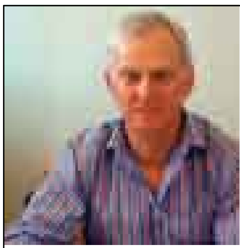
What do lenders want?
Profitable businesses are preferred, but some lenders will consider companies that are not yet in profit or have been insolvent, if they have a robust turnaround plan. These are concerns shared with banks, according to Kate Sharp of the Asset Based Finance Association (ABFA). "Lenders require good debt, a good business plan, sound management and financial credibility," she says. "You need to have your books ready and people available who know where you want to take the business." For advice on **business plans**, go to **pages 18-19**.

Lenders will constantly monitor your sales ledger, which can help identify credit risks and tighten up your processes. "Finance companies also carry out extensive credit checks on your customers and can pass this information on to you," adds Sharp.

IS INVOICE FINANCE FOR YOU?

PROS
- The amount advanced grows as your company expands
- Improves cashflow and gives you flexible access to additional funds
- Helps introduce credit control discipline

CONS
- Only really works if you sell products or services on credit to other businesses
- Not the cheapest form of finance, but the recession has made it more attractive
- You can get tied into long contracts



CASE STUDY
Stuart Dunbar is the co-founder of Oak Exports, a Cheshire-based exporter of non-perishable British food.

"We have to buy and distribute stock, and it can be up to 60 days before we get paid. As our customers are all overseas, invoice finance has proved the ideal way to handle the problem.

"There was a gap to be bridged between the 30-day payment terms we had with UK suppliers, and the 60-day terms many of our overseas customers worked to. Invoice finance means our cashflow is freed up by releasing a percentage of our invoice value, providing a smooth, consistent source of funding that grows with our sales."

The downside of invoice discounting
This isn't the cheapest form of funding, so balance your need for smooth cashflow against forfeiting some invoice value. Also, if things go wrong, you may find you're tied into a deal for at least 12 months, so before you sign up, find out what happens if you want to get out of the contract early.

Remember, invoice discounting is a competitive market, so negotiate on terms and conditions, such as notice periods. ■

For advice on the benefits of leasing over buying outright, see pages 28-29 ▶

Where to go next

For more advice on invoice discounting, visit: www.businesslink.gov.uk/discounting

For the Asset Based Finance Association, visit: www.abfa.org.uk

Making use of your assets

image: Shutterstock

You can use items like stock, machinery and premises to secure funding, and in the current climate this can help to persuade lenders to agree to a loan

Asset-based lending (ABL) is a secured business loan where the borrower uses their assets as collateral. Financiers lend on items with high sell-on values, such as stock, machinery, premises, invoices and even brands or trademarks. It is distinct from invoice discounting, as invoices make up only part of the arrangement. For more information on invoice discounting, go to pages 24-25.

Typically, you'll have access to a revolving credit facility, where you have an upper limit, but the total borrowed changes frequently, as with an overdraft. The amount is subject to the value of collateral at the time, and is constantly assessed, so the borrowing ability of a seasonal business can fluctuate. Financiers usually retain security over the assets for the contract's duration, with the lending decision based on their value.

ABL has grown considerably over the past decade. Figures from the Asset Based Finance Association (ABFA) show that in the first half of 2008, the industry advanced over £17.3bn against invoices, stock, property and other assets, which were themselves worth £31.2bn. The credit crunch has deterred banks from lending, but ABL offers security and may help you to persuade them.

IN BRIEF ASSET-BASED LENDING

- Debt can be secured against assets, including stock, machinery, premises, invoices and even brands
- Manufacturers, distributors and retailers are the most likely users. It has not been a common source of UK finance, but it is growing in popularity
- Security over assets is retained by the lender for the duration of the contract
- Lenders may advance more than invoice discounters, because they look at all the assets of the company
- Asset-based lending is provided by some banks and specialist lenders
- Some lenders have a minimum loan size of £5m

Who is it for and how much can be raised?

ABL works well for asset-rich businesses undergoing a step change. For example, those looking for extra working capital to fund growth or seeking to part-finance a larger deal, such as a management buy-out. The amount raised is down to the assessed value of the assets and the likely depreciation rate. Some assets are worth more than others:

- Invoices can secure 80-90 per cent upfront
- Plant, machinery and property also raise high advances of around 80 per cent
- Stock and raw materials tend to result in a lower advance of 30-70 per cent. Values are usually based on what assets would be worth in a 'forced' or 'orderly' sale.

Insuring your assets

"Non recourse arrangements" are worthy of your consideration in the currrent economic climate. This is where an asset based lender provides credit protection against debtor's insolvency in respect of the invoice finance part of an asset based lending facility; if a debt is not collected due to the financial inability of the customer, the factor assumes the loss. Many asset based lenders will provide this service.

What are the costs?

Typically, the annual cost of borrowing on a revolving credit facility is around 1.75-3.5 per cent above the base rate, plus an annual and/or closing fee of around 0.5-1.5 per cent of the total borrowed.

Should you decide to seek a term loan against fixed assets, you would be charged at similar rates to your credit facility. To support loans, however, the financier would have appraisals or valuations undertaken on your fixed assets. The cost of employing a valuer, which varies depending on the assets and size of facility, will be passed on to you.

You will also be charged for monitoring, relating to the constant ongoing review of your collateral arranged by your backer, along with due diligence costs (see below).

How quickly can I raise the money?

Not as quickly as pure invoice finance. The sums involved are larger and the valuation of certain assets is more complex. The lender might need the services of a specialist valuer.

You'll have to be prepared to undergo a detailed evaluation of your business (due diligence), where the lender will look at all your accounting systems. They'll value property, plant and machinery, and will review your cashflow and budget projections. You'll have to prove your cashflow is smooth enough to weather any seasonal fluctuations or unplanned drops in business.

The whole process should take four to six weeks. After signing, some lenders may allow a cooling-off period.

CASE STUDY

In 2007, Qualtech Engineering, based in Devon, produced revenues of £250,000 and had just five staff. However, director Emma Warren was keen to grow quickly.

When another engineering business, Yale Systems, was put up for sale it appeared to be the ideal opportunity. Unfortunately, the investment required was too high for angel investors and too low for venture capital.

"We decided to use asset-based lending, and raised finance by placing our machinery as security. The new combined company, UK Precision, now turns over £1.25m and has 20 staff."

What do lenders want?

Solid businesses are preferred by lenders rather than those promising huge returns.

"We seek companies with assets and prospects for improvement," says Dennis Levine, chairman of ABL specialist Burdale Financial. "We tend to finance buyouts or refinance businesses where traditional sources are less flexible."

Lenders expect to be provided with a variety of reports – daily, weekly or monthly, depending on the assets being funded. ■

For advice on bank overdrafts and loans, see pages 20-23 ▶

Where to go next

For a list of asset-based lenders from the Asset Based Finance Association, visit: www.abfa.org.uk

Should you buy or lease assets?

Purchasing important items upfront for your business may drain your cash reserves, which is something companies can ill-afford. So, consider leasing

Buying outright might sound like the simplest way to acquire equipment, as cash purchases can work out cheaper in the long run. What's more, the goods are classed as business assets, so they can be used as security. However, it may not be the best use of your working capital. A key way to survive the economic downturn is to preserve cash in your business. So, if you don't need to own the item immediately, consider leasing, which allows businesses to use valuable assets – such as machinery, cars or furniture – without paying upfront. Instead, these items are bought and owned by a finance house and leased to you for a set period.

Leasing is the most popular way for businesses to buy vehicles. In 2007, £19bn was provided to register 50 per cent of all new cars in the UK, while leasing accounted for almost 28 per cent of fixed capital investment in the UK in 2007. [Source: Finance and Leasing Association].

There are a number of leasing options. A popular long-term approach is a finance lease, where you pay a deposit followed by regular payments that ultimately cover the full value of the asset and the interest accrued.

Another option is operating leasing, which allows you to use the assets for a shorter period – the finance house can either sell or lease them again at the end of the contract.

If you don't want the worry of covering maintenance costs, consider contract hire. This is often used with vehicles, and monthly payments can cover maintenance and fuel.

IN BRIEF LEASING

- You get immediate access to the assets, but pay on a monthly basis, easing the pressure on your cashflow
- Leasing companies effectively lend you the total cost of items leased
- Almost anything can be leased – cars, property, IT and telecommunications equipment, machinery, printers and photocopiers, even furniture
- There are various tax benefits – for example, you can deduct lease costs from your taxable income
- It can take as little as a day to organise

The advantages of leasing

- Cash that would have been spent on assets can be released to finance growth
- You can deduct the costs from your taxable income. For more details, visit www.businesslink.gov.uk/taxdeductions
- You don't own a depreciating asset and can return it, offering flexibility
- You can lease almost anything, from cars to computers, machinery and furniture
- You can access the latest equipment and may get maintenance as part of the deal

The disadvantages of leasing

- A long-term lease will probably mean you pay more for the item than buying it outright
- Leased items are not classed as business assets, and so can't be used as security
- You won't own the equipment at the end of the lease

image: Shutterstock

Finding a leasing company

Most high-street banks, a range of specialist independent leasing companies and some manufacturers themselves now operate leasing arrangements.

How much will it cost?

Finance fees can vary considerably depending on the item you want and your own creditworthiness. However, interest rates are at an historic low, so, in theory, lenders should be able to offer you a good deal. It's always worth shopping around and getting a few quotes. Also be prepared to negotiate, because lenders could reduce their rates or waive charges, or be more flexible on payment terms if you do.

The most important thing is to get the type of deal that best suits your business. Deals typically span one to five years, but some can be for longer, such as those for larger, more valuable items.

Some lenders may ask for a deposit to help underwrite the deal. So, anticipate this and try to use it to your advantage when negotiating. You may be able to get lower monthly payments by offering a slightly higher deposit, because it will reduce the lender's risk.

Before striking a lease agreement, it's vital you're really sure it's the best deal for you. If necessary, get independent expert advice from a professional, such as from your accountant, who can analyse the figures and compare the tax benefits of buying outright against leasing. Your accountant should also be able to tell you if the overall cost is too high.

There are other cost benefits, too. One of the biggest savings for small businesses can be in administration. For example, it's quite common for the responsibility for dealing with a company's vehicle fleet to be added on to someone's job, and an operating lease or contract hire can help to reduce the workload and hassle involved.

CASE STUDY

East Midlands-based company Martin Wright Ltd has built a solid reputation as a vehicle diagnostic and mechanical repair company, for brands such as BMW and Audi.

The business requires specialist equipment in order to carry out its day-to-day work effectively, and had to decide whether to buy or lease those assets. After initially failing to get finance, the company obtained grant funding to help buy the equipment outright.

"Working with Business Link helped us look at all options available to us. As a result, we decided it was more suitable for us to buy because of the changing economic conditions."

For advice on making the most of the assets you own, see pages 26-27 ▶

Where to go next

To decide whether to lease or buy, visit: www.businesslink.gov.uk/lease

For advice on leasing, visit the Finance and Leasing Association at: www.fla.org.uk

Angel finance

If you are looking for financial input and guidance from experienced individual investors, angel funding could be for you. But how much can you raise and how can you go about securing it?


image: iStock

Many people are familiar with angel investing through the Dragons' Den TV series. This gives a good indication of how an angel will test your business plan, but unlike on TV, the process of investment may take months – and in a downturn there are many businesses chasing few investors.

Angels are usually wealthy entrepreneurs, and dealing with them is a less formal process than with other forms of equity finance. However, they are less predictable, and not mandated to invest. If they think they can get a better return elsewhere – from bonds, for example – that's what they will do.

Angels tend to offer smaller sums at an earlier stage than venture capitalists (VCs). This may help take your business to the point at which it will be attractive to a VC firm.

Investment from angels can be offered as a lump sum upfront, or in stages. It can be dependent on your business achieving specific milestones, such as hitting a sales target or launching an new product or service.

Angels invest to achieve a financial return, typically in the form of a capital gain through an exit. This could be realised by an acquisition of the company or a flotation, although the latter is unlikely at the moment due to the current economic climate.

"Angels not only bring money, but also experience and skills. Many have been through at least one downturn, so can help steer your business forward in challenging times," says Anthony Clarke, chair of the British Business Angels Association. Some will even take on specific management roles.

Angel funding can come through personal or industry contacts, as well as suppliers. However, the most structured way is to approach a business angel network regionally, close to your business. Each one represents a group of private individuals looking for investment opportunities.

IN BRIEF RAISING ANGEL FINANCE

- Between £10,000 and £2m can realistically be raised from individual business angels or an angel syndicate
- Sourcing angel investors might require more searching than finding venture capitalists (VCs), but private investors are more prepared to back an early-stage business
- Angels may be found through industry contacts, but a more structured approach is via business angel networks
- The process is less formal than with VCs – angels often know their sector well, and so make instinctive decisions
- You are likely to have a closer involvement with your investor as they look to add value to your business

In sectors more suited to longer-term investment, or where the potential for a big return is limited, it may be harder to get angel funding. The current economic situation means the same goes for businesses working on low profit margins or with no protectable intellectual property. This is because, like every investor, angels may currently be less likely to take on high-risk investments.

For more information on alternative sector angel investment, see page 35.

What will angels back?

Business angels invest in almost all industry sectors, but often prefer ones in which they have experience. Most invest in businesses that are past the 'proof-of-concept' stage, but young and growing firms will also be considered.

Most angels prefer to invest in companies within 100 miles of where they live or work. Investors in technology companies, however, tend to be more prepared to travel longer distances.

CASE STUDY

When Eseye co-founder Ian Marsden was looking for investment to expand his mobile technology business, based in Guildford, his priority was to find an active investor who could help him grow. So, he opted for a business angel rather than bank finance or investment from friends and family.

"For us, growth is about market focus and networking connections, and angel investors are motivated to use their contacts to make the business work.

"Getting investment was tough, but it's impossible to know who will fit your business until you meet them in person. We now have four potential investors."

ANGEL FINANCE

PROS

- Angels often invest smaller sums than venture capitalists (VCs), so may suit newer businesses
- As well as funds, they may be able to offer skills, contacts and experience
- Business angels take much higher risks than other forms of funding
- Investment occurs in most business sectors and at all stages of development
- Can be quicker and less formal than VCs

CONS

- Angels invest in only a very small proportion of the proposals they are presented with – more than 90 per cent of investment opportunities are rejected at the initial screening stage
- Many angels expect close involvement with the business they invest in, which not all businesses find desirable
- Loss of equity means loss of control of your business, which won't suit everyone

How much can be raised?

The amounts involved in angel funding vary widely from £10,000 up to £2m. However, most of the deals that are done tend to be between £75,000 and £750,000.

Most individuals invest £20,000 to £50,000 per deal. Some are happy to put up to £200,000 if they really believe in an organisation, but most of the larger sums raised occur when syndicates are formed.

Where larger amounts are invested through a syndicate, you will deal with a lead angel, who acts on behalf of the other investors.

What can the funds be used for?

Angel investment can often be used to help companies accelerate away from the start-up phase, while mature businesses sometimes use it to launch new products and services, open new premises, buy competitors or to take on staff as growth demands it.

Angel investment can be useful leverage with which to attract bank loan finance, especially if your business has previously been refused a loan.

What else can angels offer?

As well as offering the finance you need to grow your company in return for a portion of your equity, good business angels offer a range of other benefits, such as:

- **Sector experience** – Most angels will have a track record of starting or investing in businesses in your market. They know what to expect, and you can learn from their previous mistakes and successes
- **Mentoring and strategic advice** – Growing your business will involve making some big decisions, and the advice an angel can offer you can prove invaluable, so plan to meet them face to face occasionally.
- **Networking** – Angel investors typically have useful contacts, which can open all sorts of doors to other investors, potential customers, recruitment opportunities and service providers
- **Direct involvement** – Generally, your angel will want to take a seat on the board in order to be involved in decision making (if your investor is a syndicate, the lead angel will do this). If your angel considers that you would benefit from a particular strategic skill, they might take a more hands-on role – although this is much less common

CASE STUDY

In 2006, Bac2, which had developed a plastic that was a billion times more electrically conductive than other polymers or resins, wanted to capitalise on its intellectual property. To do this, it was looking for £300,000 of angel investment. Chief executive Mike Stannard sent his business plan to the London Business Angel Network, which screens companies for its members.

"We pitched to around 60 angels at once, and raised more than we were looking for. We also gained vital skills from two angels who took seats on the board, really strengthening our team.

"We have since raised a further £2m from London Business Angels for global expansion."

What to look for in a business angel?

It's important that the business angel who is willing to invest is right for your company. Before signing an agreement, you must first ensure that:

- The management team and the business angel are compatible and can work together
- The angel's skills and experience match the needs of your company

What do angels look for in you?

The factors that influence an angel's decision to invest in a business vary greatly from investor to investor. However, the following issues are likely to be taken into account when angels are deciding on funding:

- The expertise and track record of the founders and management
- The business' competitive edge or unique selling point
- The characteristics and growth potential of the market

image: iStock

- The compatibility between the management, business proposal and the business angel's skills and investment preferences
- The entrepreneur's financial commitment

What do angel investors expect?

Given the strong element of risk involved in many angel investments, investors will look for solid returns:

- Most will seek an exit in three to five years
- They will expect growth of their capital of at least 25 per cent a year, often higher
- Your management team may need to show equal commitment to the project, and be prepared to back the venture with their own money as well
- Market validation of your business through existing sales or known distributors is desirable, although it is not essential
- Business angels enjoy working with small businesses, so they expect to bring in their expertise. This means they will wish to contribute to the business' strategy and direction, which not all companies find acceptable

For more on **negotiating the terms of a deal**, go to **pages 46-47**.

What are my chances of securing finance?

Some investors make only one investment a year, while others operate a portfolio of investments. Currently, it is a very competitive environment, so pay particular attention to making sure your business plan is investment-ready.

According to the BBAA, between 95 and 98 per cent of applications are turned down. Having a strong **business plan** is essential – for more on this, go to **pages 18-19**.

You will also have to be able to demonstrate how your business will use any funds it raises to achieve specific growth objectives. At the moment, most investors are looking for an idea with strong market potential, which is scalable, and can be protected. If you can demonstrate all three, your chances of being funded will be much better.

Where can I find business angels

The most reliable way to source angels is to contact one of the many business angel networks, which sift opportunities for their pool of investors and arrange networking events for you to present your business. **The British Business Angels Association (BBAA)**, the UK trade association for business angel networks, at **www.bbaa.org.uk**, will put you in contact with your local angel networks.

Networks will have a fund manager who acts as a gatekeeper, and who will direct your business plan to the most appropriate individuals in the network. They will also be able to give feedback on whether your plan is suitable for angel funding.

With angels currently receiving many requests for funding, a personal relationship or introduction can make all the difference and should help you get past the piles of business plans vying for their attention.

How quickly can I raise funds?

It's difficult to accurately predict how long the angel investment process will take, but three to six months is typical.

CASE STUDY

Andy Redfern is a director of Newcastle-based EthicalSuperstore.com, which promotes good causes, ranging from local community movements to those seeking global impact, including a website featuring more than 5,000 Fairtrade and eco-friendly gifts.

"We started with the aim of trying out business ideas in the social sector. Initial success inspired us to produce a cross-brand ethical website to allow users to buy from one place online.

"We've had three stages of funding using business angels and venture finance. First, we raised £286,000 to start the idea, with angel investors putting in £86,000, while the further £200,000 was raised by venture finance from NorthStar Equity Investors (NSEI) Co-Investment Fund. Then we went back to the investors and said: 'We've proved the idea and need £800,000 to develop it further.'

"Not everyone reinvested, but in the second round we received £500,000 from the NSEI Co-Investment Fund, with a further £300,000 from angels.

"We have subsequently raised another £1m to allow the business to keep on growing."

Like any investor, an angel will want to carry out thorough due diligence on your business to establish its value, and uncover any weaknesses or assets that are not immediately apparent. If you are dealing with a syndicate, the lead angel will do this job.

At this time, you must be transparent about your business, your idea and your finances. Angels ask a lot of questions, but this is because they know that their investment is much more likely to bear fruit if they have an intimate knowledge of your company before they fund it.

Ask your potential angels a lot of questions too, because they will expect you to do this. While this process might seem protracted, it's a good opportunity to make sure that you will feel comfortable taking investment and advice from them.

You should also make sure you have good legal advice throughout this process.

How to value your business

Before marketing the proposition of your company as an investment opportunity to a business angel, be clear about the valuation of your business.

Broadly speaking, this determines how much of the business the angel is buying for their investment.

For example, if an angel invests £500,000 at a pre-money (excluding finance or the latest round of funding) valuation of £1m, they would have 33 per cent of the business, which would have a post-money valuation of £1.5m. Research by The National Endowment for Science, Technology and the Arts (NESTA), which looked at data from 96 investments, concluded that the pre-money valuations of early-stage businesses can be summarised as follows:

- A pre-revenue seed business would be valued at somewhere between £350,000 and £750,000

■ An early-stage business with some revenues (say, under £300,000 per year) would be valued from £500,000 to £1m.

Angels are looking for a realistic chance of achieving a high return on capital. A compound return on investment (sometimes known as internal rate of return or IRR) of 50 per cent a year is a good starting point. It may seem high, but it is commensurate with the risk. Investors lose money on around 40 per cent of the deals they make, and need to do very well on the ones that are successful to show an overall positive return.

A NEW NETWORK OF SOCIAL INVESTORS

Supported by the Government, Equity Plus is a network of individual funders and investors that want to invest in social enterprises and social-purpose businesses. It focuses on equity-based investments, looking for organisations that are interested in partnering with an investor to share the potential risks and rewards associated with any new venture. For more information about **Equity Plus**, visit: **www.equityplus.org.uk**

What are the costs?

Angel finance, especially when sourced through a business angel network, will involve costs and charges.

If you deal with a network, there should initially be no fee to view your business plan. However, networks often charge up to around £1,000 (depending on services) to arrange for you to meet their angels.

On top of this, there is also a success fee, which averages at five per cent of the funds that are raised. It's important to ask a network about its fees at the outset.

Costs are lower than VC and public market listings – for more information on these, go to pages 36-43. It is, however, a full-time activity for one person in your company, often the owner-manager, so the cost of time taken out of running the business should be calculated.

Because angels are often involved in early-stage companies, which are considered a high risk. They will expect you to be flexible and prepared to negotiate to give them a fair share of your equity in return for their investment.

Ethical angels

A trade sale or flotation for a social enterprise is complex, and hence investment by individual angels or groups of them in such organisations is rare.

Fortunately, some angels are not motivated purely by making a profit. Some 'ethical angels' invest largely because they have a desire to use their money to help improve society, and are less driven by making a return through an exit.

If you are seeking an investment for an ethical business, there are other ways to reward them for investment other than a trade sale or an flotation – through a dividend payment, for example.

While there are growing number of angels who want to invest in social enterprises, the networks for accessing them are not, as yet, well established. ■

For advice on pitching your business to investors, see pages 44-45 ▶

Where to go next

For more details about angel finance, visit: www.businesslink.gov.uk/angels

For more information on business angle networks, visit: www.bbaa.org.uk

image: iStock

Venture capital

If you're looking to raise up to £10m and are prepared to share control and equity in your business, then venture capital funding may be right for you

Companies that harbour ambitious growth plans often turn to venture capitalists (VCs) to fund their expansion strategy in return for a significant stake in the business. The VC takes some of the risk, has a say in direction, seeks a high return and usually exits in three to seven years, often through a trade sale or market flotation.

What do VCs look for?

Proof of concept and maturity will be expected by VCs, unless you are running a new business with a proven management team, or, following a period of research and development, you are about to launch a new product or service.

VC's generally prefer it if:

- You are near to profit already
- Your overheads are tight
- You don't over-value your business
- You can demonstrate the market potential of the product or service
- You have a good rapport with them

What growth strategies will they back?

VCs are looking for rapid expansion plans that can deliver the required returns, such as an acquisition, product or service launches, new markets, or the establishment of a chain. Increasingly, VCs are wary of businesses that use a lot of working capital with low margins. In a downturn, these can quickly slip from profit to loss, and find it hard to recover. VCs currently favour businesses with some type of protectable asset, such as intellectual property that can be exploited.

They are also looking for businesses in areas that show growth potential. For example, technology companies, particularly those that are involved in the fields of biotech and 'cleantech', stand a far better chance of investment in the current economic climate. So do the creative industries, involving design or software development. They use less operating cash, have the potential for high growth, and often have intangible

IN BRIEF RAISING VENTURE CAPITAL

- It usually takes between three and eight months to raise funding, sometimes longer
- Owner-managers will often be expected to give up at least a 20 per cent stake in their business
- Venture capitalists back high-growth strategies, such as: acquisitions; product or service launches; new premises; or national, European or global business expansion
- An exit through flotation or trade sale is expected within three to seven years

assets like intellectual property, which can be licensed.

No business will be funded, however, without solid evidence that there is growth potential and a strong market. When pitching your growth strategy, you will need evidence that this is the case.

If your business is selling to sectors or markets that are relatively robust in a downturn – such as telecoms and technology businesses – it may stand a better chance of gaining funding.

VCs will look to see how you have protected your assets, and will want to see a realistic plan for exploiting them. Many will be able to help with advice, but you need to have the basics in place before you attempt to get funding. VCs do not invest in hope.

How much can be raised?

Companies that are looking for venture capital for the first time can raise up to £5m, although some smaller regional VCs and VC Trusts (VCTs) will make investments from £50,000.

However, remember that if you are raising money from VC structures that feature tax incentives for investors – such as the Enterprise Investment Scheme (EIS), VCTs and the Corporate Venturing Scheme (CVS) – you are limited to raising £2m in any 12-month period. See over the page for more information about VCTs and the EIS.

CASE STUDY

London-based managing director and co-founder of Latin America-themed restaurant chain Las Iguanas, Eren Ali, raised £27m through a combination of venture capital (VC), debt and equity.

"This was a very different round of fundraising from the £3m that we were able to secure back in 2002, which was composed of part VC funding and part bank loan.

"The deal was agreed with Bowmark Capital, and was made up of £10m of equity, and around £8m of bank debt. Myself and another co-founder also rolled out £9m of equity between us.

"For this stage of our brand roll out, Bowmark Capital was a more suitable partner and more accustomed to doing deals of this size."

If your business is a start-up, or needs investment to get off the ground, you should also consider angel investors. For more information about business angels, see page 30.

Be aware that VCs have other demands on their cash, and that you might have to wait for investment. They might also need cash to support existing investments while they wait for an exit.

VENTURE CAPITAL FINANCE

PROS

- Investors can add valuable skills and open doors for your business
- Investors may provide follow-up funding as your business grows

CONS

- VCs reject 95-98 per cent of prospects, and are currently particularly cautious
- Medium-sized to large investments are more attractive than smaller ones

image: iStock

How will the business be valued?

A standard way for VCs to value a more established company is a multiple of the profits or earnings ratio – usually four or five times. It is important to be realistic about the valuation you give your business. VCs may seem to be undervaluing it, but they are using criteria based on their experience. If you disagree with their valuation, use evidence that they might not have, such as sales data, the performance of other businesses in your sector, or negotiations with potential partners.

Where can I find VCs?

The British Venture Capital Association (BVCA) is a good source of VCs, and has a full list of members at **www.bvca.co.uk**, with details of their preferences. Accountants, lawyers, and corporate finance and business advisers should also be able to introduce you to potential investors. Other routes include: business contacts; events matching investors with ambitious businesses; and investment-readiness programmes run by VCs, accountancy firms and corporate finance specialists. Some VCs ask for enquiries through their websites, although in the current market, a personal introduction has much more chance of success.

What are the costs?

VC is more expensive than angel finance. Advisers' fees are the main cost to consider:

- Corporate finance advisers usually take at least five per cent of the money raised
- Typical legal fees are £20,000-30,000

THE ENTERPRISE INVESTMENT SCHEME

Designed to encourage venture capital (VC) investment from smaller investors, the Enterprise Investment Scheme (EIS) offers a number of tax breaks, including income tax relief, on investments of up to £500,000. If you're looking for growth capital, but small amounts of VC are too expensive, attracting EIS investment from a private investor might help bridge that 'equity gap'.

Here's how the scheme works:

- The investor buys shares in a company, investing up to £500,000 in any year
- The shares must be 'ordinary', with no protection from risk or preferential treatment for dividends and assets
- Income tax relief for investors would be 20 per cent for the value of the shares
- Investment must be long-term – for at least three years.
- Investors cannot be 'connected' to the company, such as a director, someone with more than a 30 per cent stake, or an employee. But, under some conditions, they can be an existing angel investor

For more details on EIS and the reliefs available, visit: **www.hmrc.gov.uk/eis**

- Specialist accountants usually charge a percentage of funds raised or an hourly rate of between £200-400 in London, or £175-300 outside

You also have to pay the VC fees and due diligence costs. The VC's percentage is usually higher for smaller fundraisings, as they involve a similar amount of work to raising larger amounts.

Overall costs vary widely, but are typically eight to 15 per cent of the money raised. Some advisers may take part of their fees as equity options, or be happy to only get paid if the fundraising is successful.

Raising VC is still cheaper than going public, where issuing a formal prospectus for a flotation through a nominated adviser could cost £100,000-500,000.

For more on the costs and expert advisers, go to pages 10-11.

How quickly can I raise VC funding?

It may take as long as six months or more to complete the VC funding process, so you shouldn't embark on fundraising without enough cash in reserve. It can involve months of preparation, many visits to investors' offices, detailed due diligence and some knock-backs.

It's better to start early, as investors will not participate until the necessary due diligence has been done. Also in a volatile market, some will prefer to wait until they have more assurance over economic conditions.

How does the investment work?

You're unlikely to get funds from a VC all in one go, unless you're prepared to give up far more equity. VC investors prefer to provide finance when you have achieved pre-agreed milestones. These could be set as a particular level of turnover growth, or the delivery of a certain target. This could be making an acquisition, or progress relating to products or services.

VCs will often expect to agree a mix of debt and equity, to ensure investee companies are paying something back over the duration of the investment.

What rights do VCs expect?

In a typical deal, VCs will be looking to agree certain rights of veto, or for areas

VENTURE CAPITAL TRUSTS

Established to encourage venture capital (VC) investment in small companies, Venture Capital Trusts (VCTs) are listed investment vehicles.

VCTs invest in unquoted businesses or those listed on the Alternative Investment Market (AIM). Instead of investing directly in companies, investors buy shares in the VCT, which then invests the money in various companies.

Investors are elligible for 30 per cent tax relief on investments under £200,000 in any one tax year, and capital gains tax relief on disposal of those shares. Plus, VCT dividends are exempt from income tax.

In addition, VCT strategies vary. Some trade on AIM, some are generalists, some prefer technology investments, while some are environmental funds.

Appetite for risk and willingness to invest depend primarily on their strategy, not on business plans.

Only from one in 20 to one in 50 of the business plans that VCTs evaluate actually gain investment.

For information about the VCT investment regulations, go to www.hmrc.gov.uk/guidance/vct.htm where they expect to have an influence. These include:

- Significant items of expenditure
- Hiring and firing key staff
- Major acquisitions, disposals or strategic alliances, and any fundraising strategies involving giving up equity
- Significant changes in business strategy
- Control over key staff members' and the management team's remuneration
- Dividend payments

There will also be restrictions over what management are able to do if they leave the business, such as being barred from forming a competing company, working for a competitor or poaching staff for a set period.

While some of your autonomy may be lost, VCs expect to work with you and share a common interest – growing the business. Providing that you communicate well and bear your investors' interests in mind, too, the relationship can run smoothly.

image: Shutterstock

For more information about **negotiating the deal**, go to **pages 46-48**, and for more on **investor relationship management**, go to **pages 49-50**.

CASE STUDY After raising three rounds of funding in two years, Simon Ball, London-based chief executive at online business insurance marketplace Coverzones, recommends telling a simple business story in your pitch. He also says statistics are key and advises flexibility over equity.

"You can never do enough research on your market or your competitors. Also, be prepared to give up the majority of equity in your business if you want to grow quickly. It isn't necessary to have a majority shareholding to keep your autonomy in management decisions. Ask yourself whether you want 50 per cent of a £1m business, or a smaller percentage of a £1bn business?"

What returns do VCs expect?

VCs will be looking for a significant return on their investment, and they will be more interested in facts and figures than projections and promises about how you will achieve this.

You may have to deliver the required return within three to seven years into an agreement, depending on the investor and the condition of their portfolio. Others may wait eight to 10 years.

To boost the chances of achieving a sale or eventual flotation, VCs will scrutinise your procedures, management team and accounting systems. This can include your investor joining the board, appointing an independent chairman or bringing in a finance director with VC experience.

What about social enterprises?

VC is open to social enterprises, but it may not always be appropriate, or they may find it difficult to access. VC investors that operate in the social enterprise arena still want to see the same commitment and good management as their counterparts working with purely commercial businesses. However, they may also be interested in social returns.

According to ethical bank Triodos, social investors look for the following qualities in a business when considering funding:

- An experienced and well-balanced team with a good track record
- A strong idea that meets potential demand within the market
- Strong growth potential in the relevant target market
- A sustainable competitive advantage over rivals in the sector
- A financial position that's close to breaking even or making a net profit
- A desire to share ownership of the business with an investor that can bring more than just money
- Potential exit routes identifiable at the time of investment

Social enterprise exit options

One reason that may discourage VCs from investing in the social enterprise sector is a perceived lack of exit options. Social enterprises can place a limit on the proportion of their shares that can be traded publicly on the stock markets. They can also restrict how many shares one investor might hold, or allow founders to issue and retain a golden share.

It can then be harder for a social investor to find a willing buyer for its stake in the business, once it is ready to realise its investment. However, one way that this can be achieved successfully is by giving the management of the social enterprise the opportunity to buy back the shares from the outside equity investor. This can be done once the business is in a stronger position with respect to cashflow.

EXIT STRATEGIES

Venture capitalists (VCs) want their investment to grow, but they also want to get their money back. Therefore, to attract venture capital (VC), you need a plan for returning the investment at the end of the agreed term – known as an exit strategy.

You will not be able to precisely identify the exit, but you must plan for it from day one in order to secure VC investment.

The most common exit option is selling your business to another company – known as a trade sale. This could be your entire business or part of it, and it can be the best way to generate the biggest return on the VC's investment.

You could also consider a merger with another company, although this would probably mean remaining with the business for longer than if you make a straightforward trade sale.

Meanwhile, floating your business allows you to realise your investment by making it easier to sell all or part of your stake, but this is currently very difficult to achieve.

For advice on negotiating with investors, see pages 46-48 ▶

Where to go next

For more on equity funding options, visit: www.businesslink.gov.uk/equity

For a directory of all UK investors, visit the British Venture Capital Association at: www.bvca.co.uk

image: iStock

Should I float my company?

For raising £1m or more, a stock market listing may be your best option. It is often the next step after angel and venture capital funding, but it can be a complex process

For businesses that want to grow rapidly and raise their profile, a flotation on the Alternative Investment Market (AIM) or PLUS is worth considering. Typically, you can raise far more money through an initial public offering (IPO) than by other means.

What are AIM and PLUS?

AIM is the London Stock Exchange's (LSE's) junior market for growing companies, and provides a regulatory framework to allow for both the flexibility a growing company needs, and the appropriate levels of protection. For more information on the listing process visit: www.londonstockexchange.com/AIM

IN BRIEF FLOTATION

- PLUS is good for raising sums in the lower millions, AIM for larger amounts. Strong growth potential is necessary, and a track record of profit is helpful
- Fees account for seven to 10 per cent of finance raised on AIM. This can be less for PLUS, but the ratio of fees to funds generated can be more for smaller IPOs
- Flotation takes up to six months – you must be prepared to share some control and be strictly regulated

PLUS is a fully competitive UK stock exchange, focused on small and mid-cap companies, offering the complete range of stock exchange activities. For more details, visit: www.plusmarketsgroup.com

What can you use the markets for?

The main purposes of a stock market flotation are to raise money, establish a clear value for the company's shares and improve its profile in the public eye and media.

AIM is home to more companies than any other growth market, but has not been immune to turbulence in the global economy. Today there are around 1,500 companies on AIM, with UK incorporated AIM quoted companies employing over 260,000 people.

PLUS has positioned itself as an alternative to AIM with its PLUS-quoted market. PLUS has grown steadily and attracted some entrepreneurial businesses, as well as encouraging a few AIM-listed companies to also list on PLUS.

How much can I raise?

At the moment, it is very difficult to raise money as the economic climate has made investors more risk averse. Investment from venture capital trusts (VCTs) has largely disappeared because rule changes introduced in 2006 mean that they cannot invest in businesses with assets worth more than £7m, or that employ more than 50 people. Both factors have led to companies getting far less investment, and share price liquidity has seriously suffered.

To join AIM, companies do not need a particular trading history and there is no minimum requirement in terms of size. PLUS caters for smaller entrepreneurial companies looking to raise sums in the lower millions, although there were exceptions that raised far more.

CASE STUDY Janine Woodward is the Bristol regional manager at The Ethical Property Company, a social enterprise that buys properties and develops them as centres that bring charities, cooperatives, communities and campaign groups together under one roof. She explains how the business has handled flotation.

"A bank specialising in funding social enterprises acted as lead adviser for two of our share issues in 2001 and 2003, raising a total of almost £6m. While the offerings were successful, we realised that our shareholders needed to be able to buy and sell shares in order to maintain liquidity.

"Potential shareholders were worried about liquidity, so we've worked hard to find ways to get it. As a result, we now use Brewin Dolphin to run a matched bargain market, which helps us to provide the liquidity our shareholders want."

If you're considering floating on the junior stock markets the costs can be considerable, and there is a shortage of liquidity, which limits the funds available for investment.

What are the costs?

Fees are made up of adviser's costs and the broker's commission, which is a percentage of funds raised. Adviser fees vary considerably and depend on the size of the deal. However, small and medium-sized companies can expect to pay £500,000 or more for an AIM flotation, and in the region of around £200,000 or more on PLUS.

On both markets, a company requires specialist help in the form of a nominated adviser (NOMAD) on AIM, and a corporate adviser on PLUS. These advisers orchestrate the listing process, linking your company, the City, your accountants, lawyers, brokers and a financial PR firm. For more details on choosing the right financial advisers, go to pages 10-11.

You will also need to take into account the cost of the time and resources that your management team will have to put into the IPO, which is likely to be considerable.

How quickly can I raise funds?

Typically, it takes five to six months, although this varies according to the complexity of the flotation. Sometimes, to make the process faster, companies start with an 'introduction' to one of the markets, which involves joining without raising funds. This also helps investors assess your management team and its ability to perform in the public arena.

For advice on finding the right advisers, see pages 10-11 ▶

Where to go next

For more advice on AIM and PLUS, visit:
www.businesslink.gov.uk

Making the perfect pitch

Whether pitching to angels, venture capitalists or investors prior to a float, find out how to structure your presentations and which tools to use

If investors have seen your business plan or executive summary (for more details, go to pages 18-19) and want to hear more, it's time to hone your pitch, as it will be crucial to securing the investment you need when you meet up. But there's no point pitching unless your company is properly prepared.

Are you investment ready?

There are lots of programmes that specialise in preparing businesses for investment. They help to align your company as closely as possible to the interests of potential investors, as well as refining your business plan. Regional Development Agencies (RDAs) provide Understanding Finance for Business, a Solutions for Business product, which includes advice on investment readiness and can be accessed via Business Link. Once you're 'ready', its time to prepare your pitch.

What format does a pitch take?

First meetings generally take place at the investor's offices, although some prefer to see your business and its processes. An investor may provide guidance on the presentation format, so ask first. Otherwise, after the introductions, you set the agenda.

You are typically expected to make a formal pitch, although some investors encourage informal discussion. Plan to talk for about 30 minutes, covering the key points, using slides where appropriate. Backers may interrupt with questions and hold a more detailed, and potentially lengthy, Q&A session at the end if they are interested.

"Have as many back-up slides as required. If the investor is interested, he will ask to drill down in certain areas, so ensure the slides are clear and to the point," suggests Jamie Davies of the Business Advice Bureau. Meetings can last from one to three hours.

IN BRIEF THE PITCH

- Details of your management team are as important as your business concept
- Take a team of around three
- Aim to present for around half an hour
- Cover history, products, finances, the growth opportunity, market conditions, and a SWOT analysis
- Anticipate tough questions, and think about how you will answer them

CASE STUDY

Hugh Scantlebury is the co-founder of London-based online accountancy service Aqilla. His business raised an undisclosed sum from private investor Bob Morton in January 2009.

"We wanted funding to create a sales and marketing infrastructure for our business, spending six weeks preparing a prospectus before sending it out to 21 investors. We followed up with email and arranged a number of meetings.

"There's no point pitching to someone who doesn't invest into your area. Try to meet people through referrals, as they will always be more responsive."

image: iStock

What should the presentation cover?

- Any developments since your submission
- The quality of your team – it's often more important than details of your products
- Relevant industry experience and expertise
- A précis of the business' history, progress and financial performance to date
- Market opportunities, who your customers are and why your product or service will appeal – see the investor's viewpoint by focusing on the business opportunity
- Your balance sheet, cashflow, historic profitability, trends and projections – justify targets with graphics, such as pie charts
- Realistic figures – a common mistake is to exaggerate demand, sales, etc
- A Strengths, Weaknesses, Opportunities and Threats (SWOT) analysis to show that you have studied any potential flaws. For more on **SWOT analyses**, visit: www.businesslink.gov.uk/swot
- A best and worst-case scenario of how your business may perform
- A summary of key points

The aim is to present the necessary details that will help to solidify the investor's interest in your company. So avoid discussing the terms of the deal, as this will come later, and the investor will not consider it appropriate.

Who should present the pitch?

Around three people, with the owner-manager covering the areas above, your sales specialist detailing the opportunity, and your finance manager presenting the figures. Also, gauge your audience. A few light-hearted comments may help, but jokes can backfire.

QUESTIONS INVESTORS ASK

1. Are you filling a gap in the market? Who are your potential buyers, and is there a broad spread or small concentration?
2. Do you know your market. Is it growing or shrinking? What are the constraints?
3. What barriers face market entrants, and is the product easy to reproduce? Are there any copyright or patent issues?
4. Have you suffered difficult trading patterns or loss-making periods?
5. Which staff are critical, and how can you encourage them to stay?

What presentation tools should I use?

Any you're confident with. PowerPoint is popular, but ensure the necessary equipment is available, and take a back-up paper copy. Use graphics, but keep demonstrations short.

For top **presentation tips**, visit: www.businesslink.gov.uk/equitypitch

For **presentation courses** visit: www.businesslink.gov.uk/training

Should I rehearse?

Do at least one practice run with your team, and read through your proposal, so you don't contradict what's written in your plan. Agree key details to avoid quoting conflicting figures, and swot up on financial jargon. ■

For advice on how to negotiate with investors, see pages 46-48 ▶

Where to go next

Further advice on pitches can be found at: www.businesslink.gov.uk/equitypitch

Agreeing the terms of the deal

Interested investors will issue a provisional contract called a term sheet. Be prepared to ask some probing questions to ensure it's acceptable to you

After a successful pitch, investors will send you a document stating the conditions with which they expect to go ahead. Known as a 'term sheet', it will set out the key points of the final contract, including a description of what is for sale, the amount they propose to invest, the funding method, their expected return and an exit plan. It is not legally binding and is open to negotiation.

Your legal adviser should help you with any jargon (for tips on **finding a solicitor** visit **www.businesslink.gov.uk/solicitor**), and a corporate finance adviser or specialist accountant can identify key points for negotiation. For more on **professional advisers**, go to **pages 10-11**.

IN BRIEF NEGOTIATIONS

- Businesses needing immediate capital will start from a weaker position
- Make sure that the investor is offering an adequate level funding
- The right chemistry between you and your investor is often more important than raising the full amount
- Younger businesses, or less profitable companies, may have to give up more equity to seal the deal
- Exits can often be determined by the investor, so try to make sure that you retain your rights on this issue and have some input into the decision
- You have a right to know who your investor wants to place on the board and what powers they expect them to have

Deals are often a mix of equity (finance for ordinary shares) and debt (a loan arranged by the investor). If you have a choice of backers, the term sheet will help you decide who to go with and what terms to accept. By signing it you will have agreed to deal exclusively with that investor. The deal must work for both parties, so consider the following:

Is the investor offering enough?

Be clear about this. You're selling part of your business and its value will be key. There is no right price and no set way to value it, which often leads to disagreement. **Valuations** depend on what the buyer will pay and what you'll accept. However, the present value of expected future cashflow is one figure often used. For other ways to work out the value, visit: **www.businesslink.gov.uk/valuations** You are in a stronger position if you've had more than one offer. Be confident, as this is a meeting of equals. You're not asking for a handout – you have something they want.

How does the investor assess their risk?

During the due diligence process, where investors scrutinise information about your company's past, present and future status, you will need to hand over a lot of intimate knowledge about your business. This comes under the warrenties contract, which requires the business owners to provide any and all pertinent information on the business. This helps investors assess the risk of investing, which is hugely important and depends on a series of factors. These include the overall state of the market, the

maturity and financial track record of your business, and the ability of your management team. This can be a daunting task, and business owners may want to get a lawyer to explain why this is done and how it can help push negotiations along.

"Due diligence was tough. We faced a barrage of questions for six months," says Eren Ali, managing director of restaurant chain Las Iguanas, which raised £3m in venture capital (VC) and bank debt.

It is important to be upfront and honest about potentially deal-breaking issues, such as lawsuits, tax investigations or simply unexplained gaps in accounting or management. If they unearth things they feel increase their risk, you may have to accept less favourable terms or lose the backer.

Are they the right investor?

No investor is perfect. The one you feel most comfortable with may not be offering enough, while another may want to back you, but on unacceptable terms. Personal relationships are key, as you're going to be working closely, so you should like and trust each other.

Will they offer further fundraising?

Investors may not like companies asking for more money without prior warning, so if you plan to seek second-stage funding, address this in advance. Also discuss bringing in other backers at a later date, what kind would be appropriate, and how to prevent the original investor's stake being diluted. Try to retain as much flexibility as possible.

VCs may even agree to provide further finance in the future without taking more equity, according to Baker Tilly's head of M&A and private equity, Rob Donaldson. "Where the VC is a big shareholder, they won't want to dissuade the management team by diluting their stake more, and funding to accelerate growth may be in their interests to hasten their exit," he says.

How long should the exit period be?

Investors will typically look for an exit in three to five years. Some may want a clause in the contract to force an exit, while others are happy to wait until the most appropriate moment for both company and investor. Ensure you have similar ideas of how to realise value in the business, then work towards that target. For more on investors and exit strategies, see pages 36-41.

What is their track record like?

Every investor has a different style, and it's useful to know what this is. Ask to speak to

BEFORE YOU JUMP HEADLONG INTO NEGOTIATIONS...

Approach the discussions over the deal with caution. The small print is arduous and designed to dilute the risk for the investor, which may propose to structure a deal in an unexpected way. So, before you enter negotiations, ask yourself the following questions:

- How badly do you need the money?
- What terms would you accept?
- Could the company survive without investment and, if so, could you grow it at a slower rate and seek finance at a later date when better terms can be agreed?

other companies in their portfolio, as they will know how the backer works. Find out the type and frequency of reporting they expect and how involved they like to be in the business.

What is negotiable and where are the potential pitfalls?

The value of the business, how much equity you give up, or the interest on any debt and legal issues are key areas for negotiation. Ask how you'll be able to access funds, if they will be structured and released in tranches, and what conditions are attached? Also, find out in what form the funds will be offered.

"Nine times out of 10, investors will structure their investment (or much of it) as a loan, leaving you having to pay interest, but still giving away equity. However, earlier stage companies are less able to service debt, so are more likely to get pure equity. But they'll have to sell more of the business in return," says Donaldson.

He adds that interest on a loan note can range from three to 15 per cent and is an area to negotiate on keenly. If you have more than one offer, ask your corporate finance adviser to run a financial model for you to see which method will cost you more.

Can you vet a proposed board member?

VCs are reluctant to impose someone on a business. So ask about: their background and why the VC has put them forward; what skills, contacts and knowledge they can add; and their intended role as a board director – will they be hands-on?

Don't assume that it's down to the investor to suggest a non-executive director. You may know the industry better and be able to recommend a candidate who will add value to the business – although investors will still appoint one of their own, too.

How serious are they?

Before you sign the term sheet, you need to be convinced the investor is committed to the deal and will complete the process. Serious investors will start due diligence the day after you sign.

"Be warned, some hand out a term sheet to knock out the competition, but will then slow the process, which could weaken your hand in future negotiations. It's not unreasonable to make them show they are serious," says Donaldson. Make it a condition of signing that they immediately start due diligence in return for exclusivity. ■

For advice on managing your relationship with investors, see pages 49-50 ▶

Where to go next

For more on agreeing the terms of a deal, visit the BVCA website: www.bvca.co.uk

image: Shutterstock

Managing investor relations

Funding from angels, venture capitalists or a flotation brings obligations. By understanding them, all parties can enjoy a rewarding relationship

Once you secure finance, you'll need to manage the relationship with the backer according to the terms agreed. Most expect regular reports, such as monthly accounts. Equity investors may ask for the minutes of board meetings and input into your business, including the right to veto decisions. For more on the typical rights investors expect, go to pages 36-41. In return, investors will offer financial advice, strategic guidance and help recruiting management, as well as contacts and market information.

Delivering on profit and sales forecasts is crucial to forming a successful relationship with your backers. It builds their confidence in your organisation, and, if you have floated, your share value will depend on it.

IN BRIEF INVESTOR RELATIONS

- Keep communication personal, whether face-to-face or by phone. A good relationship can benefit you both
- Ask your backers what information will be required, how often, in what format, and by whom
- Funds can boost your business, but may be withheld if targets are not hit, and deals can even be vetoed
- Make realistic projections; be honest about bad news

What information do backers expect?

- If you have taken on debt, backers will want to see monthly management accounts and audited annual accounts. They may also want aged-debtor analysis – not only details of what you are owed, but also how long you've been owed it.

CASE STUDY

Bob Jones, chairman of Swindon-based IT business Equiinet, managed to raise £2.75m from venture capitalists (VCs), business angels and trade investors.

"VCs and private investors have had a positive impact. Monthly reporting is a good discipline that helps us focus.

"However, they shouldn't interfere too much. You know your business better than they do.

"Private investors sometimes want to get involved in the business, but that can cause confusion over who's running things. Our VCs appointed a non-executive director who attends the monthly board meeting. We report figures and he asks probing questions and gives advice."

MAKE YOUR INVESTOR RELATIONSHIP WORK BY ASKING KEY QUESTIONS

1. What information do you require us to provide – accounts, forecasts, analysis, commentary, etc?
2. What areas do you expect to have input on – management pay rises, acquisitions, appointments, new service, product launches, etc?
3. How often will we need to provide you with the required information – monthly, quarterly, annually?
4. In what format do you expect it – as a Word document, PDF, Excel or other spreadsheet, PowerPoint presentation, or a perfect-bound document?
5. How do you like to receive it – by email, post, phone or face-to-face?
6. Who should provide our business information and manage the relationship – another board member, the owner-manager or someone else?

- Venture capitalists (VCs) will also expect in-depth coverage of your profit and loss, balance sheet and cashflow. An analysis of your company's performance compared to budget is often required, as well as commentary on progress made against stated goals at the point of funding, and the forthcoming year's budget
- Active business angels may want similar levels of information; passive ones will be happy with monthly or quarterly reports
- Quoted companies' shareholders must have equal access to formal information, such as trading updates, profit warnings and information on takeover talks
- Expect frank questions from institutional shareholders, and answer them honestly. Investors will be far more supportive if you do, and may be able to offer good advice

How should information be provided?

The more detailed and personal the better. Try to combine sending it with meetings or phone calls. In general, management and annual accounts are sent as Excel or PDF documents, but find out the preferred format.

How much input should be expected?

Advisory firm Baker Tilly's head of M&A and private equity, Rob Donaldson, advises sharing key decisions with lenders, as they will offer as much input as possible. "The lender can act as a useful sounding board, and it is important they understand why you have taken certain decisions," he says.

VC firms, however, typically expect a seat on the board, usually as a non-executive director. Some angels want occasional contact, others daily. The input you accept largely depends on their stake. "You should listen to minority shareholders, but you don't necessarily have to follow their views," says Donaldson. "Those with a larger stake have more influence."

Like you, your backers' want a healthy, profitable and well-run business. Keep them on-side early on, manage expectations effectively and the level of influence expected will gradually diminish as their trust grows. ■

For advice on business angels and venture capitalists, see pages 30-41 ▶

Where to go next

For further advice on financial and management accounts, visit: www.businesslink.gov.uk/equityfinance

For more on investor relations, visit: www.bvca.co.uk/publications

Help for growing businesses

There are a number of schemes run by the Government to help businesses grow. The kind of support your company is eligible for will usually depend on your location, the type of business or the specific project you're working on

As part of its commitment to helping businesses, the Government provides support through grants, tax credits and allowances, loans, training and events. Until recently, this help was provided by several bodies, but under the Business Support Simplification Programme it has become much easier for businesses to access the help they need.

Solutions for business
Now, nearly all the government-funded support programmes available to businesses and entrepreneurs have been brought together in Solutions for Business, a single portfolio of around 30 products. While these are administered and delivered by a number of organisations, Business Link offers a single point of access.

Business Link advisers can provide an overall view of the help available and identify the most appropriate schemes for your company. They will then broker the service, putting you in touch with the relevant body, which may be a local authority or a Regional Development Agency.

The process of migrating government support into the Solutions for Business portfolio is scheduled for completion by March 2010. The products available include: advice on starting a business; structured coaching for managers of fast-growth businesses; and understanding finance for business. There is also a lot of help available to support innovation, including grants for research and development, and collaborative research.

For more information, please visit: **www.businesslink.gov.uk/solutions** ■


image: iStock

IN BRIEF **GOVERNMENT SUPPORT**

- The Government has a range of schemes to support companies. These include grants, loans and allowances
- Grants might sound ideal, but eligibility criteria are stringent and the application process can be long
- Grants are usually only allocated for a specific project or purpose
- Regional Development Agencies run schemes, often focused on innovation, to support local businesses
- Businesses can also make use of subsidised consultancy offered by experts in given fields
- Some private firms may also offer awards and loans to businesses at preferential rates

Getting a grant

Your company may qualify for government funding, which could mean you don't need to get into debt or give up equity to raise the money to grow. So check before pursuing other forms of finance


image: iStock

Most business grants sound appealing because your company will get an influx of cash that you probably won't have to repay. However, applying for a grant is not something to be taken lightly. The application process can be slow and will certainly be rigorous. To succeed, your company will have to meet stringent criteria.

Who hands out the money?

Business grant schemes are available from the Government, the European Union, Regional Development Agencies, local authorities, Chambers of Commerce and County Enterprise Boards. By March 2010, all government grants will be accessible through the Solution for Business portfolio, with information available from Business Link at **www.businesslink.gov.uk/support**

Which companies are eligible?

Grants are almost always for proposed projects, not activities already underway. These may include opening up a new division or branch in an area in need of economic regeneration, or could be tied to new activities in existing businesses, such as exporting or development. There are even grants to help companies benchmark their business against their competitors. A grant will often go towards covering the cost of bringing in a consultant to help with these projects.

Strict terms and conditions are applied to grants, and you may have to pay the money back if they are not followed.

Grants rarely meet the full costs of a project. You can expect to receive 15-50 per cent of the money, so you'll need to find at least half of the required funds from alternative sources to cover the shortfall.

Applying for grants

Your local Business Link office will be able to help identify relevant products or support under the Solutions for Business umbrella, together with relevant European grant schemes.

Before you apply for a grant, you will need to have the following:

- A detailed description of the project
- An explanation of its potential benefits
- A detailed work plan and full costings
- Information about your relevant experience and that of other key managers

Your proposal will be assessed on its relevance to the grant's aims, your approach and your expertise.

Applications usually fail if the business plan is unrealistic, if the funds requested aren't matched adequately by the applicant, or if it's unclear how important the required finance is to the project's success.

For more details on **grant applications**, visit: **www.businesslink.gov.uk/grants**

Types of grant

There are a variety of government funding schemes available depending on what you need the money for, all with different terms

Investment and research

Regional Development Agencies (RDAs) administer **Grants for Business Investment (GBIs)**, a Solutions for Business product. These are available for a number of purposes, including the acquisition of buildings, machinery and equipment, and programmes that will help create or safeguard jobs.

RDAs have also traditionally played a hugely important role in promoting innovation. They provide support for proof of concept projects under **Grant for Research and Development (GRD),** a Solutions for Business product.

At the early stage of a research and development (R&D) project, sums of up to £20,000 are available to help companies prove there is a market for a particular idea.

For instance, before launching an expensive research programme, it is essential to know whether there is a sufficient customer base to justify the time and cost involved, and also whether the intellectual property will be defensible.

image: iStock

If the idea proves to be viable, the company can then apply for further research grants usually of up to £100,000 (but higher for some sectors) and development grants of up to £500,000. This funding is intended to take a company up to the stage of pre-production prototype or small scale demonstrator. It can also fund pre-clinical research and intellectual property protection.

Businesses receiving support through GRD may also be able to access specialist RDA-funded facilities, such as business incubators and science parks. Businesses that are successful at the proof of concept stage may also benefit from help **becoming investment ready (see pages 44-45)**.

For more details on these types of grant, visit: **www.businesslink.gov.uk/solutions**

Collaborative R&D

If your business is working on an R&D project with another company or a university, it may be eligible for a grant under **Collaborative R&D**, a Solutions for Business product, delivered by the Technology Strategy Board (TSB). To qualify, the project must involve two or more collaborators, with one of those being a business. The grants cover from 25 per cent to 50 per cent of the costs of the project.

European cross-border collaboration is fostered through the European Union's (EU's) **Seventh European Framework Programme (FP7)**, which runs until 2013 and has a budget of more than €50bn. FP7 funds a variety of leading-edge R&D and support activities with grants of up to 75 per cent. It's open to all types of organisation and usually requires at least three partners from different countries. For more on FP7, visit **www.fp7uk.dti.gov.uk**

The **Eurostars** programme benefits cross-border collaboration between small to medium-sized companies (SMEs) that dedicate more than 10 per cent of their staff or turnover to R&D. For more on Eurostars, visit www.innovateuk.org

Grants are available for technology projects aiming to bring new products to market. To qualify, at least half of the work must be done by an SME, and the research should involve participants from at least two EU countries.

You can also get finance through FP7 for Joint Technology Initiatives. These are public/private partnerships bringing businesses and public research bodies together to develop cutting-edge technology in specific areas.

For more on the Technology Strategy Board, visit: www.innovateuk.org

Additional expertise

The Government also provides funding to help small companies work with knowledge-based institutions, such as universities and colleges, in the development of new products and services.

The process is run through Innovation Vouchers, a Solutions for Business product, which is being rolled out in England by RDAs. The vouchers provide small companies with grant finance to purchase the necessary expertise from the relevant educational or research institution.

The concept underpinning the scheme is simple. A company identifies a short-term problem that can't be solved internally, and finds an institution that can help. The business can then apply for a voucher, which will buy specialist support from the institution.

Support worth up to £10,000 is available, but typically the amounts involved are between £3,000 and £7,000.

In addition to providing help to resolve a specific issue the Innovation Voucher scheme aims to encourage further collaboration between the knowledge base and business.

For more information about Innovation Vouchers, visit: www.businesslink.gov.uk

Other sources of government finance

Alternative sources of public support and funding for growing businesses

Loan guarantees

If you're having trouble providing security for a bank loan, you should investigate the Enterprise Finance Guarantee (EFG) scheme, a Solutions for Business product, offered jointly by the Department for Business, Enterprise and Regulatory Reform, banks and other financial institutions. Under the scheme, which is open to businesses with a turnover of £25m or less, the Government will underwrite up to 75 per cent of loans from £1,000 up to £1m. The EFG can cover new loans, the refinancing of existing ones and the conversion of overdrafts into term loans. Replacing the

image: iStock

Small Firms Loan Guarantee scheme, the EFG runs until March 2010. While it is not sector specific, European Union rules prevent it being extended to certain sectors. Your lender can assess your eligibility. Visit Business Link, at www.businesslink.gov.uk/solutions, for more information.

Funded jointly by the European Commission and the European Investment Bank (EIB), the Risk Sharing Finance Facility (RSFF) is primarily aimed at large companies, but smaller businesses can also benefit. It involves loans and loan guarantees linked to research and development (R&D) that either forms part of a Seventh European Framework Programme (FP7) or are compatible with FP7 objectives (see page 53). If the loans amount to less than €7.5m, the scheme is accessed through participating banks. Above this, interested companies go direct to the EIB (www.eib.org/products/loans/special/rsff/index.htm). With EIB, the Government has helped UK banks to negotiate credit lines of more than £1bn to provide loans to small and medium-sized businesses.

Research and Development Tax Credits

Tax relief is available for R&D that aims to achieve a scientific or technological advance. This scheme applies to companies with less than 500 full-time staff or equivalent, and the rate of relief is 175 per cent of qualifying R&D expenditure when calculating profit for tax purposes. Businesses not in profit may be entitled to a 24.5 per cent cash payment for every pound spent on R&D. From 1 April 2008, larger companies can claim relief of up to 130 per cent of qualifying expenditure. Other tax breaks available include capital allowances for investment in equipment and premises, plus stamp duty relief in disadvantaged areas.

For more information on R&D Tax Credits, visit: www.businesslink.gov.uk/taxbreak

CASE STUDY

Newcastle software developer Nonlinear Dynamics has claimed 24 per cent of its qualifying research and development (R&D) costs from HM Revenue and Customs under the R&D tax credit scheme. CEO Will Dracup explains the process:

"We spend a lot on R&D. For instance, in the 2004/2005 tax year, R&D costs were nine per cent of turnover and 30 per cent of sales. But annual claims under the R&D credit tax scheme have clawed some of this back. Initially establishing the basis of the claim and setting up the necessary audit trail was hard work, and needed good management information systems. Since then, claiming has been straightforward, and has provided real motivation to keep investing in R&D."

SBRI Contracts

Public sector development contracts are available through the SBRI programme, where companies can bid for technology-based R&D contracts. The tendering process is designed to appeal to small and medium-sized companies.

Several government departments plan to hold competitions in 2009 to seek innovative solutions and products for specified problems and unmet needs. For example, one of the pilot competitions invited proposals to help improve hand hygiene in hospitals. Successful companies will be awarded a contract to prove the technical feasibility of their proposals usually within six months and for up to £100,000. The most promising technologies will get a further contract for demonstration of product capability,


image: iStock

to be completed within two years, and for up to £1m. As distinct from a grant, the Government is a customer rather than the provider of funds. If the technology is proven, there is the prospect of a full supply contract. The intellectual property will remain with the company, although the Government may retain certain rights. SBRI is being championed by the Technology Strategy Board, and details of current competitions can be found at www.innovateuk.org/sbri

Knowledge Transfer Partnerships

Like Innovation Vouchers, Knowledge Transfer Partnerships (KTP), a Solutions for Business product, fosters cross-fertilisation between education and business. Under KTP, funding is available to bring a recent graduate in to help businesses provide an answer to a problem they cannot solve themselves internally. The Government will provide up to 67 per cent of the cost.

Funding is currently provided for projects lasting one to three years, but a short scheme of 10-40 weeks is being rolled out. The scheme benefits the institution (through research material), the graduate (through gaining experience) and the participating businesses. For more information on the Knowledge Transfer Partnership scheme, visit: www.KTPonline.co.uk

Knowledge Transfer Networks

Funding is also available for Knowledge Transfer Networks, part of the Solutions for Business Networking for Innovation product, to bring together businesses, academics and the Government to share knowledge in emerging technologies. There are currently 25 networks operating, funded by participating businesses, educational institutions and the Government's Technology Strategy Board, which provides grant support. For more information, visit: www.innovateuk.org

Real help for businesses now

Further support is available to companies through the Government's 'Real help for businesses now' initiative.

This includes:

- Help with business funding, including further details on the Enterprise Finance Guarantee and regional loans, plus free guides on managing company finances
- How to reduce waste and save energy
- Dealing with staff restructuring and major business change
- Advice on alternatives to redundancy
- Funding for skills development, plus free, independent advice through Train to Gain. For more information about 'Real help for businesses now', visit www.businesslink.gov.uk/realhelp or call 0845 600 9006

Helplines

- The Capital for Enterprise Fund provides equity investment to pay off existing debt or grow your business. For more information, see page 33 or call 0845 459 9780
- For help with exports, visit the UK Trade & Investment website at www.uktradeinvest.gov.uk or call 020 7215 8000

For details on more support, including help with finance, premises and manufacturing, visit: www.businesslink.gov.uk/solutions


image: Shutterstock

Additional funding opportunities

It's not only the public sector that provides support and grants for businesses. Many private organisations also offer awards and assisted loans that may prove invaluable

The Carbon Trust

Companies working with technologies that could cut carbon output may be eligible for financial support from the Carbon Trust. Carbon Trust Investments funds low-carbon enterprises that show commercial potential. To date it has co-invested £10.8m across 12 companies, which together have raised £110m. For instance, the trust has recently invested £1m into 4energy, an innovative cooling system developer. For more information, visit: www.carbontrust.co.uk/investments/venturecapital/

Through its Innovations programme, the Trust also helps develop commercially viable, low-carbon technologies through partnership, funding, expert advice and large-scale demonstrations. Many promising low-carbon technologies are still in their infancy, and by providing support, the Trust aims to bring them to market more quickly.

Applied research funding of up to £500,000 is available for business and academia. For more details, visit: www.carbontrust.co.uk/technology/appliedresearch/

The Trust also runs an incubator scheme and investment-readiness workshops. For more information, visit: www.carbontrust.co.uk/technology/incubator/

Ambient Assisted Living Programme

Part-funded by the European Union, the Ambient Assisted Living Programme plans to spend €600m (split equally across private and public sectors) between 2008 and 2013 on technology projects to help elderly people. In addition to engaging on research that meets the necessary criteria, applicants must be involved in cross-border collaboration. For more information, visit: www.aal-europe.eu

NESTA invention and innovation scheme

The National Endowment for Science, Technology and the Arts (NESTA) runs an invention and innovation programme that supports people with outstanding ideas for new products or services, often at a much earlier stage than other funders. For a directory of schemes available in your area relevant to your business size, visit: www.businesslink.gov.uk/support

Community Development Finance

Providing funding services to generate both social and financial returns, Community Development Finance Institutions (CDFIs) lend and invest in deprived areas and underserved markets that cannot access mainstream finance. Average loan sizes range from £5,000 to £50,000, with larger loans available for social enterprises. For details on CDFI's that lend to social enterprises, visit: www.cdfa.org.uk.

The Community Development Venture Fund (CDVF) invests from £150,000 to £2m in businesses located in the most deprived parts of England. For more information, visit: www.bridgesventures.com

Think your business needs finance to grow to the next stage, but not sure where you can find it?

If you run a successful business and are looking to expand, there are a range of potential finance options. The **No-Nonsense Guide to Finance for High Growth and Innovative Businesses** can help you locate the most appropriate one for you, and advise you on the best way to secure it.

This guide includes:

- Working out how much funding you need
- Funding options and how to secure them
- Getting the most from your relationship with your investors
- Government schemes to help innovation and encourage growth

Business Link
This guide is brought to you by **Business Link** on behalf of the Department for Business, Enterprise and Regulatory Reform and the Department for Innovation, Universities and Skills. Contact **Business Link** for a wealth of information and support services to suit your individual needs:
Tel: **0845 600 9 006**
www.businesslink.gov.uk

Other No-Nonsense Guides available from Business Link include:
The No-Nonsense Guide to Small Business Funding
The No-Nonsense Guide to Government Rules and Regulations for Setting Up Your Business

For business support and advice:
- In Lowland Scotland, contact **Business Gateway;** (Scotland) **0845 609 6611; www.bgateway.com**
- In Scottish Highlands and Islands, contact **Highlands and Islands Enterprise; 0845 609 6611; www.bgateway.com**
- In Wales, contact **Flexible Support For Business; 03000 6 03000; www.business-support-wales.gov.uk**
- In Northern Ireland, contact **Invest Northern Ireland; 0800 027 0639; www.nibusinessinfo.co.uk**

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