No-Nonsense Guide
to Small Business Funding

Where to find expert advice • Getting the right finance

Business planning • Keep the cash flowing in

Expanding your business • Choosing a loan

Are you eligible for a grant? • Buying, leasing and hiring

Business Link

NO-NONSENSE GUIDE TO SMALL BUSINESS FUNDING

WELCOME

If you're starting your own business, it's inevitable that you'll need some financial assistance at one time or another.

It may be that you need a loan to get your venture off the ground, or an overdraft to see you through the first few months of trading. Perhaps you may need help buying equipment or credit for purchasing materials before you get paid yourself.

Raising money may seem difficult, but it needn't be that arduous so long as you ensure the fundamentals are in place.

This guide incorporates the experiences of businesses just like yours, along with advice from industry experts, so you get an inside practical view of how to be successful. And as it is from Business Link, the Government-backed business support service, there is no product sell or bias – just objective guidance on what is available within the marketplace.

Clearly this guide can only ever be a starting point. We hope that as a result of using it you feel better positioned to access the support you need. Should you need to talk to someone then our Business Link advisers will be only too pleased to help. To find your local Business Link, phone 0845 600 9006 or visit www.businesslink.gov.uk

Finally, more established businesses seeking larger sums to finance their next stage of growth may be interested in our No-Nonsense Guide to Finance For High Growth Companies. This can be ordered by either calling 0845 600 9006 or by visiting www.businesslink.gov.uk

How to use this guide

The guide divides into four sections:

1. PREPARATION
Use this section to work out what you have to do before you approach anybody for funding. It gives advice on deciding how much money you need and for how long, how to choose an expert adviser, and developing a business plan.

2. FUNDING OPTIONS
This looks at the financial choices available and helps you pick the right one for your business. It will answer questions on loans and overdrafts, buying or leasing equipment and grant eligibility.

3. MAXIMISING BUSINESS FINANCE
Once you've got the right finance in place we look at ways to keep your business running smoothly. Topics include effective credit control, tackling late payers and invoice financing.

4. TAKING THE NEXT STEP
This section offers a brief guide to growing your business further, once you've successfully navigated the early stages. We also explain who Business Link are, and how to contact them.

For more detailed advice on funding growth for more established businesses, see our companion publication, the **No-Nonsense Guide to Finance for High Growth Companies**.

For more detail on all these issues, visit the Business Link website at **www.businesslink.gov.uk**, for a comprehensive range of advice and to locate your nearest Business Link office.

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4 TAKING THE NEXT STEP

FIND THE RIGHT SECTION

"I want to grow my business, but I don't know whether to borrow, seek investment, or use my own money. What should I consider? "

The right finance for you

Before thinking about the different forms of finance, you should ask if external funding is really the right path for your business

In this guide we'll direct you to the sources of finance most likely to help you fund your business. But before you approach a lender it's important to establish why you need the money, how much you will need and for how long. Use the Business Link Start-up Organiser to help you **work out your priorities** at **www.businesslink.gov.uk/organiser**

If you're already running a business you should also investigate opportunities to tap into resources that already exist within your company before you look for external finance. See the **Hidden Funds** box, below, for details.

What do you need the cash for?

Starting up a new business: Have you researched your new venture thoroughly? Any lender will want to be sure there's a need for your product or service. For a guide on how to carry out this **market and customer research** visit **www.businesslink.gov.uk/marketresearch** Instead of going to a lender for finance, can you start building your business on a smaller scale, funding it yourself in the early stages? Think about freelancing or continuing with a part-time job while the business gets off the ground.

Buying equipment: Taking finance will add commitments and overheads to your company, so remember to consider all your options. Can you lease the equipment instead, or simply hire it as needed? What's the most tax efficient option for you and your business?

Buying premises: Could the money you spend on property be better put towards running and growing your business? Would your business be better off in rented premises?

Seeing the business through a lean period: Before you get a loan or overdraft to see you through, consider all the other options available to you. Could you reduce stock levels, or find new ways to tackle late-paying customers, or perhaps you could negotiate better deals with your suppliers (see **Hidden Funds** box)?

Expanding the business: Is your business ready for expansion? Do you have the resources in place to handle the growth? Read our guide at **www.businesslink.gov.uk/businessgrowth** to help determine if your business is ready to grow.

Rapid growth: If your business is growing fast and you need to look at the options for raising large sums of money, other

HIDDEN FUNDS

Before you get yourself into debt with the bank, check the finance you need isn't already within your business. Many companies look to finance to solve problems that could be better solved by restructuring the way they work.

If you're hoping to fix a cashflow problem, you may be better off looking at how you deal with the cash within your business before trying to raise extra finance.

Are you tying up too much cash in stock? Could you improve your **credit control procedures** and get money in from customers more quickly? Perhaps **factoring** or **invoice discounting** could help, by advancing you money on your invoices (for details, go to **pages 26-29**). What about moving parts of your business out to third parties (outsourcing)? You'll find out more at **www.businesslink.gov.uk/outsourcing**

Further advice
For tips on drawing up a business plan pages 10-11

finance options may be more suitable. For more on attracting outside investors to your business (for example business angels and venture capitalists) read the No-Nonsense Guide to Finance for High Growth Companies.

How much do you need and when?
Borrow too much and you could end up paying interest on money you're not using – too little and you could end up relying on an expensive overdraft facility to top up your funding, or even having to shelve the project mid-way through.

It's vital to accurately predict how much money you're going to need – and for that you need a business plan. Prepare a cashflow forecast for the first year. This will estimate how much cash should flow in and out of your business each week and month. Assume a worst-case scenario – costs are usually higher and sales lower than you think.

Do you need short or long-term funding?
Short-term funds, such as an overdraft, are suitable for day-to-day needs (working capital). For example, an overdraft could see you through the first few months of business, while you wait for money to come in from customers.

For longer-term projects, such as buying property or machinery that will be vital to your business, long-term funding, such as a loan, will be a more cost-effective solution.

Preparing to get the money
Whoever you approach for business funding, you have to be prepared to answer the following questions:
- Why do you want the money?
- What will you use the money for?
- How much are you personally putting into the business?
- How much do you need to borrow?
- How and when do you plan to repay it?
- Do you have any security?
- Have you considered other options and why do you think this one is the best way forward?

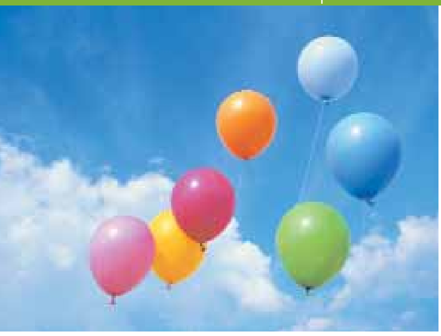
ASSESSING YOUR OWN ATTITUDES TOWARDS RISK

Starting your own business inevitably involves an element of risk, and increasing your debt through loans and overdrafts all adds to that risk. To get the right funding for your business you need to think about your attitude to those risks.

For example, are you willing to stake your home on your business by remortgaging your house to raise funds? Or do you want to limit liability by choosing a safer but higher cost option, or even starting smaller and choosing to grow gradually?

Harry Cragoe, founder of PJ Smoothies, found that he needed to sell up everything to give him the incentive to move his business forward, while EasyJet founder Stelios Haji-Ioannou recommends you only put in what you can afford to lose. What about friends and family? Would you feel uncomfortable taking money from them and perhaps putting them at financial risk? Would you rather borrow from a bank or get a cash injection from an investor in return for a share in your business?

"I need funding to get my business started. What choices are there, and how can I find the most appropriate one for me?"



FUNDING A NEW BUSINESS

Banks are still one of the most common sources of funding for new businesses in the UK, but there are other options and many entrepreneurs choose a combination of finance types

Self-funding Most small businesses start on a modest scale; owners use their savings, investments and assets to help raise funding.

Pros

- You get all the profits and retain control
- You don't have any interest repayments or loan charges (unless remortgaging your home)
- It demonstrates your commitment, which can influence financiers at a later date

Cons

- You're using up cash reserves that could be useful if your business hits a rough patch
- Assets used to raise money, like your home, are at at risk if you don't keep up repayments

For more on **self-funding**, go to **pages 12-13**.

Friends and family This is a cost-effective way to get finance. To fund a short-term cashflow problem consider a loan. For a longer term solution, consider giving them a share in your business in return for investment. You need to be honest with investors about the risks, and should draw up a formal agreement.

Pros

- Family and friends are more likely to be supportive of your idea
- The terms and conditions are usually more generous than those of a bank

Cons

- It can sometimes test relationships

For more on accepting funding from **family and friends**, go to **pages 18-19**.

Government support Your bank may ask for security against a loan – such as your business premises or house. If you have trouble providing this, you may be eligible for the Small Firms Loan Guarantee (SFLG).

For more on **SFLG eligibility**, go to **page 16**.

Grants Discretionary grants are available for some new businesses, usually in specific industry sectors or geographical areas.

Pros

- The money does not have to be paid back
- You don't give up a share of your business

Cons

- The application process can be long
- A grant typically only covers between 15-50 per cent of your costs

For more on how to **apply for grants**, go to **pages 23-24**.

Bank loan You pay back a certain amount each month, plus interest, for a set period.

Pros

- A clear repayment schedule means you can forward-plan your cashflow
- You don't give up control of your business

Cons

- Banks can be reluctant to loan money to start-ups with no business track record
- Your bank will probably ask you to come up with a share of the capital

For more on **bank loans** go to **pages 14-17**.

Investments If you're prepared to give up a share of your business, consider investment from business angels – private entrepreneurs who typically invest from £10,000 to £750,000.

Pros

- You don't have to make loan repayments
- You gain the contacts and skills of the investor

Cons

- You will have to relinquish some control over your company (and profits)
- They may look for a management track record, so might not be suitable for new businesses

For more on **business angels**, **go to page 25**.

Further advice
For advice on sorting out cashflow problems page 26-29

ACQUIRING ASSETS

At some point your business will need assets – machinery, computers, even premises – is it best to buy outright or should you lease, hire or rent?

Loan If you want to own the item there are several options, including taking out a loan from a finance provider or friends and family.

Pros

- Buying the item outright could be cheaper
- The item can be classed as a business asset, so could be used as security for the loan
- You may be able to claim tax relief on interest and capital allowances on the asset purchased

Cons

- You need to compare the cost of borrowing (including interest repayments and fees) against the cost of alternatives to make sure you get the best possible deal
- If you don't keep up with your loan repayments your goods could be repossessed

For more on **bank loans**, go to **pages 14-17**.

Hire purchase (HP) HP allows you to buy goods on credit and you pay off the cost over a defined period. Although legal title passes to you at the end of the term, for tax purposes you're classed as the owner from the outset.

Pros

- You can choose fixed repayment, so costs will not rise with interest rates
- You may be eligible for capital allowances, which allow you to offset the costs of some assets against the profits of your business
- You can claim the VAT back on payments

Cons

- You may have to pay a deposit upfront
- HP is not suited to items where maintenance costs are high, or that go out of date quickly

Leasing Unlike hire purchase, with leasing you never actually own the item. Instead you pay a finance company for the use of it, in regular instalments over a fixed period.

Pros

- As the repayments are scheduled, you can match them to your company's cashflow
- As part of the deal, the leasing company may include maintenance and insurance costs
- You can claim back VAT and deduct lease costs from taxable income

Cons

- Items can't be classed as a business asset if you need to arrange further borrowing
- You may end up paying more in the long term

For more on **leasing options**, go to **page 20**.

Hire If your business needs equipment, office furniture, vehicles, manufacturing machinery and so on, first ask yourself how frequently you need to use them. If you only need the equipment occasionally, investigate hiring them in on a daily, weekly or monthly rental basis.

Pros

- You don't have to pay for maintenance or insurance
- Payments are tax deductible
- You only pay for the equipment when you need it

Cons

- The goods cannot be classed as an asset of your business
- If you hire the item regularly it could be more expensive than buying it

For more **advantages of hire** go to **pages 20-21**.

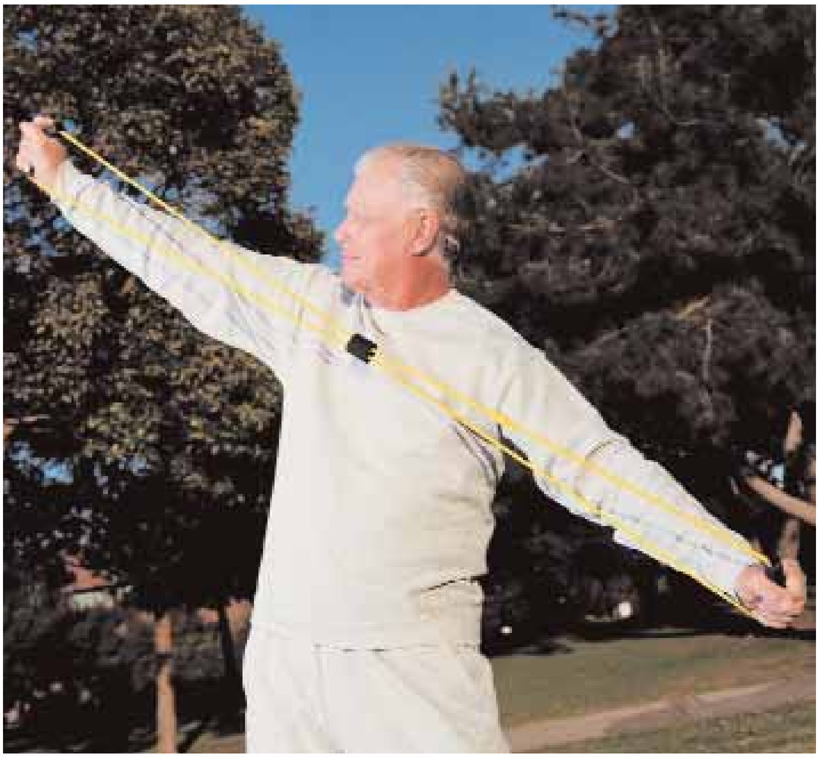
"My business needs some extra money to cover day-to-day costs. Are there any ways to raise this without using external finance?"

TACKLING CASHFLOW PROBLEMS

Releasing funds that already exist in your business is a far more cost-effective way of tackling cashflow problems than seeking a loan. You may also be able to make your existing income go further to cover those regular expenses, such as salaries and bills

Getting money rolling in promptly is vital for any business; it can make all the difference between a company that just gets by, and one that thrives. If you're having problems getting paid by your customers on time, find that you're constantly overdrawn or perhaps are just going through a period of irregular cashflow, for example a seasonal lean period, there are a number of techniques you can use to help resolve these issues. Here are some possible strategies to help your business:

Get paid on time Send your invoices out promptly, ideally at the point of delivery, and don't be afraid to chase debts as soon as they're due. You can also encourage your customers to pay you promptly by offering them a **discount incentive**. For more details see **pages 26-29**.



Order less stock more often If you're holding too much stock, you could be tying up cash that would be better used to cover day-to-day expenses. Look at ordering tactically. This could mean ordering items in smaller amounts but more often, which could encourage a steadier flow of cash through your business.

For details on **efficient stock control** visit **www.businesslink.gov.uk/stock**

Advancing money against your invoices
You could look at raising finance against the security of the money owed to you by your customers. Invoice finance is like borrowing and involves a factoring business or invoice discounting company advancing you money against your invoices as soon as you issue them.

Pros

- A factor may advance you more money than you would typically be able to get from a bank
- It speeds up cashflow by removing the time-lag between when you issue an invoice to a customer and when you get paid for it
- Factoring can be an effective way of outsourcing your sales ledger activity

Cons

- It doesn't work for all businesses – you really need to sell goods or services to other businesses on credit
- There may be more cost-effective methods of financing (see opposite)

For more on **cashflow problems**, go to **pages 28-29**.

Further advice
For tips on planning your next business move page 32

YOUR BUSINESS – THE NEXT STAGE

Taking your business on to the next stage, moving to bigger premises, buying a competitor or investing in new machinery to handle bigger orders, often involves a further round of funding

Bank loan This can be a cost-effective option.

Pros

- If you have been trading for a few years, the bank may be more willing to give you a loan
- You have a clear repayment schedule, so you can forward-plan your cashflow

Cons

- You may be asked for some kind of security – particularly if the loan is over £25,000
- Your loan could be secured against business assets – if you fail to meet payments the lender can close your business down
- The bank may ask you to come up with a share of the capital to fund the growth
- The bank may require you to have a fall-back option, such as some kind of insurance

For more on **negotiating the best deal** with your bank manager go to **pages 14-17**.

Friends and family loan A cost-effective route to finance may be to ask friends and family for a loan or to invest in your business.

Pros

- Repayments should be flexible and are often cheaper than those of a bank

Cons

- They may expect some kind of involvement, or share in the business, in return for funding
- There is a possible danger of family conflict if the loan details are not clearly understood

For more on **negotiating terms with friends and family**, go to **pages 18-19**.

Grants You could be eligible for a grant to help develop new products or enter new markets.

Pros

- There are grants for specific projects – such as developing in a specific region of the UK
- The money does not have to be paid back

Cons

- The application process can be involved, demanding and competitive
- A grant is unlikely to cover all your costs – typically you get 15-50 per cent of the total
- Grants are usually for proposed projects only, not those that have already started

For more on **grant eligibility**, go to **page 23**.

Investment options External investment from a business angel (an entrepreneur who typically invests somewhere between £10,000 and £750,000 into small businesses) can be a reliable source of funding for growth.

Pros

- You don't have to make loan repayments
- As well as funds, business angels offer skills, contacts and experience

Cons

- Not all businesses are attractive to investors – angels look for a good management track record and strong growth potential

For more on **attracting investors**, go to **page 25.**

Joint ventures Pooling the resources and expertise of two or more businesses can be a cost-effective way to grow both companies.

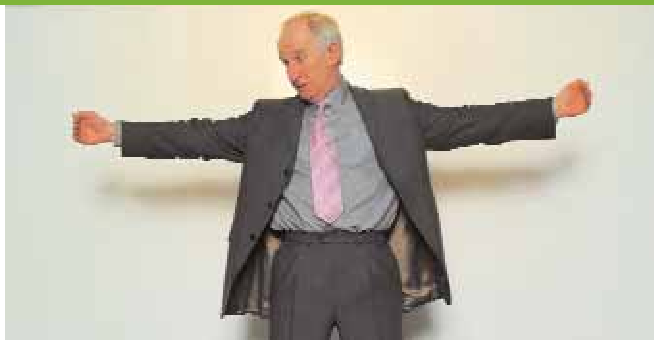
Pros

- Working with another company could help your business develop new products, increase your capacity and move into new markets

Cons

- You may have to relinquish some control over the management of the business
- You need to ensure you aren't adding extra costs to your business or losing market share

For more on getting the best from **joint ventures and partnerships** visit **www.businesslink.gov.uk/partnerships**



Getting the right financial advice

Small businesses may be reluctant to spend money on expert advisers, but they can be a wise investment, providing essential financial support

IN A NUTSHELL

- **Budget for expert advice and view it as an investment rather than a cost**
- **Approach Business Link for advice on raising finance and specialist advisers**
- **Develop your own bookkeeping skills**
- **Shop around – meet and interview any potential adviser in person**
- **Get everything (including fees) in writing**

The right adviser can be vital to the success of a business – whether you're raising funds to get a new venture off the ground or you're growing an existing business.

The first port of call should be Business Link, where a local adviser can help you get an objective assessment of your business needs and how to prepare a suitable business plan. They can also help you find specialists who can advise you on the types of finance to consider.

It's also worth approaching your bank; most have specialist teams to look after small businesses. They can recommend external advisers, as well as giving you financial advice.

Getting advice from an accountant

You may decide to do some of the bookkeeping yourself, but remember, using an accountant could help you save money. They will ensure that you claim for all your legitimate expenses and the tax allowances you are entitled to, which will probably save you money when your tax bill is being calculated.

On a broader level, an accountant should be able to advise on raising finance, managing growth, budgeting and cashflow issues. They may be able to help you with your business plan and suggest tax-efficient ways of seeking backing or investment. Read our guide to choosing an accountant for your business at www.businesslink.gov.uk/accountants

Choosing the right adviser for your business

- Talk to those whose opinions you trust. Speak to local businesses and find out where they go
- Set a budget and shop around for the best deal
- Understand the charging terms – find out if they charge by the hour, or whether they'll agree to an all-in annual fee. Ask them for an estimate of their costs
- Get everything agreed in writing
- Interview any potential adviser, make it clear what you expect from them, and find out if they have experience in your market or industry and how they can help you develop your business
- Get client references in writing, or find out names of people you can speak to

Jenny Fiztpatrick owns The Fine Food Store in Stamford, Lincolnshire, and saw the benefit of using a local adviser. "I chose a reputable firm used to dealing with small companies that knew the local market," she says.

Further advice
To find if your business may be eligible for a grant pages 23–24

CASE STUDY Going down the DIY route

Michelle De Bruyne used an accountant to set up her company, AmHealthy, which offers ShapeUp and Health programmes. However, she decided to save money on subsequent fees by doing her own bookkeeping.

Michelle is very organised. "As receipts come in I put them into labelled folders," she explains. "If something is paid for by cash, the receipt goes into the cash sleeve, if by bank account into the bank account sleeve, etc. All the paperwork is kept in an ordered filing system."

When it comes to inputting the figures, Michelle uses an accounting package provided by her bank when she opened a business account. "It allows for categories such as marketing, administration, telecoms and stationery," she says, "so I can enter the relevant figures from the filed receipts."

Michelle uses bank statements as a prompt to enter data onto the accounting system and to reconcile things.

Good organisation has been the key to the success of Michelle's DIY system. "Track everything, even small amounts of spending," she advises. "Develop a system you can work with and keep a routine for doing your records – and don't let it slip."

Learning the skills yourself

Before you employ an accountant, it is worth investigating how much of the work you can do yourself. This can be cost-effective, but will take you away from other areas of your business. You may be able to manage your accounts without a bookkeeper, or save on accountant's fees by giving them more detailed information.

For James Marsh, founder of Rookbeare Farm, an ice cream manufacturer in Devon, the key is organisation. "We do our own payroll using the tax and National Insurance information from HM Revenue & Customs," he says. "The tables are straightforward – it's just a question of being organised."

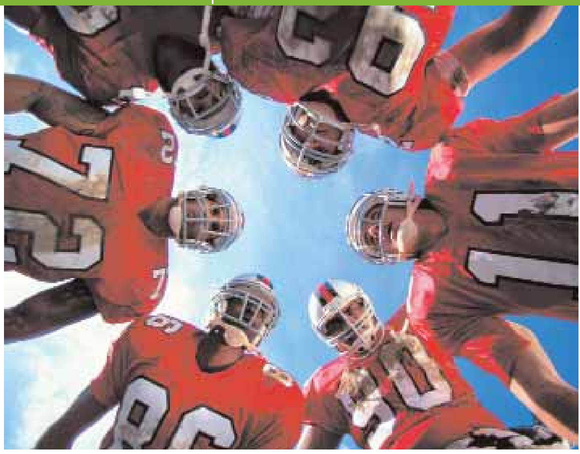
It's important to know what money you have coming in and out of your business, so keep an eye on your expenses and profits. This will ensure there are no nasty surprises at the end of the year when you get your tax bill. Read our advice on setting up your own record keeping system at www.businesslink.gov.uk/bdotg

Having a basic knowledge of accounting will also stand you in good stead when it comes to producing a business plan and presenting it to potential investors. They will want to see evidence that you have a sound grasp of your business's financial situation. ■

WHERE TO GO NEXT

- For details of local training courses on financial management:
  Business Link
  www.businesslink.gov.uk/training
- For details on choosing an accountant:
  The Association of Certified Chartered Accountants
  www.acca.co.uk
- For a directory of accountants:
  The Institute of Chartered Accountants
  www.icaewfirms.co.uk

"I know I need a business plan but I don't know where to start. What should it include and who can help me put it together?"



Planning for your business

Regardless of whether you're raising finance from a bank, friends, family or even investing your own money, you'll need a sound business plan

IN A NUTSHELL

- **A plan should address points including: Why does your business exist? Where do you want it to go? How do you plan to get there, and how much will it cost?**
- **Get help from your local Business Link adviser, bank manager and accountant**

Every business should have a realistic business plan – whether you're starting up and looking for funding or if you've been up and running for years.

A good plan can have many benefits: it will give your business a sense of direction, telling you where you're going and how you're going to get there. It's also a vital document when you're looking for funding – without one you can't convince a potential lender that your business proposal is achievable. And it gives you something concrete against which you can measure your progress, keeping your company on track.

Recent research also reveals that having a business plan can help increase your profits. Companies that undertake regular business planning have an average profit margin of 54 per cent, those that don't average 35 per cent (source: Lloyds TSB).

What should your plan include?

A business plan doesn't have to cover every single aspect of your business, but it does have to answer the following questions:

- What are the objectives for my business?
- How will I achieve these objectives?
- What are the risks involved?
- What is the timescale?
- How much will it cost?

A lender will expect to see information on:

- **Management:** The key people, their experience and knowledge of the industry
- **Product or service:** Details of the product or service you're going to offer
- **Markets:** A description of the market size, customers, competitors and sales estimates

Forecasting your financial needs

Financial forecasting can be tricky. You need to forecast at least one year ahead and include any supporting assumptions and evidence (order books, sales enquiries etc). Projections should include a monthly profit and loss account, monthly cashflow projections, balance sheets and a capital expenditure budget.

Once you've worked out your projections you'll know the total funding needed. You then need to explain how you plan to use those

Further advice
For tips on choosing an expert adviser pages 8–9

CASE STUDY Discovering the real value of business planning

Darren Jones, founder of the care business AKC Home Support Services, admits writing the business plan was initially a bit of a chore but he now sees it as core to his business: "We set out the financial and strategic goals we wanted to achieve in the short and long term. We review the plan annually now, unless there's a significant shift in our market and then we immediately re-evaluate our goals."

The plan also helped the company avoid expanding too quickly, as Darren explains: "Early on we were offered work in another county. This seemed great but when we looked at our business plan – and particularly our cashflow forecasts – we realised it was more important to establish a firm base in one county before taking on work in another one."

funds and how you're going to repay them. For more information about how to go about working out a cashflow forecast, read our comprehensive guide at www.businesslink.gov.uk/cashflow and try our sample cashflow projection.

Potential pitfalls

Stephen Pegge, chairman of the small firms' panel for the British Bankers' Association, says there are some common pitfalls to avoid when producing a business plan.

"Over-optimism is the biggest problem," explains Stephen. "This can stem from not firmly basing plans on research evidence.

"Underestimating costs – especially where buildings and refurbishments are involved – is common. You need to factor in the inevitable delays and the costs of over-running," he advises.

Getting the business plan right was vital for sporting trip organisers Tours4.

"We needed a thorough plan in order to demonstrate to tour operator insurance companies and banks that our idea would work," explains founder Daniel Smith. "We thought realistically about every business scenario that we would encounter, and consequently there haven't been any nasty surprises. We have stuck to it so far, but a good business plan should be able to adapt to every new situation."

Who can help?

The first port of call for many businesses is their accountant – many accountants offer general business advice, as well as help with the financial side of your business.

For help with the details and appropriate training courses try your local Business Link adviser. Your bank manager may also be worth approaching for advice.

WHERE TO GO NEXT

- Use our Business start-up organiser to help you through the planning process step by step:
  Business Link
  www.businesslink.gov.uk/startingup
- For more on what your business plan should cover:
  Business Link
  www.businesslink.gov.uk/businessplan

Self-financing your business

Using your own funds – be it your savings, redundancy money or cashing in personal assets – can be a cost-effective way to raise finance

IN A NUTSHELL

- **Personal funds include savings, shares and assets such as your house or car**
- **Can be used at any development stage**
- **Before you commit the money, make sure this is the best use of your cash**
- **Talk to an accountant about tax breaks**

Two out of three small businesses in the UK were started with their founders' own money (source: www.thisismoney.co.uk). But personal cash injections could come in useful to fund growth at any stage of a business's development.

If you've got the money or personal assets, self-funding seems like a cost-effective and logical way forward. But before investing your life savings or remortgaging your home, make sure this really is the best way of financing your business by **drawing up a business plan** (for more details, go to **pages 10-11**), calculating a realistic rate of return and deciding objectively if it's the most sensible use of your money.

But remember, if you don't believe your business idea is sound enough to put your own money into, banks and other external investors are unlikely to fund the venture. If you're having doubts, revisit your business plan, and if you need an impartial viewpoint, get a friend or adviser to go through it with you. For tips on **choosing an expert adviser**, go to **pages 8-9**.

Even if you put your own money into the business you may still have to borrow from the bank or look for investment from family and friends, in which case you would need to include the interest charged and other fees in your business plan. For more on **getting the best deal on a loan** go to **pages 14-17**.

Sources of personal funding

Funds can be from many sources: credit cards, personal savings, shares, money released from personal assets or remortgaging your home.

Match your funds against your short and long-term financing needs. For example, spending on personal credit cards should only be done to finance short-term expenses or if you can take advantage of any introductory interest-free finance deals. Avoid using cards to make long-term purchases – interest rates are high and if you don't make the repayments you will be personally liable.

For long-term finance (to cover start-up costs or to help finance the purchase of new premises, for example) you could look at releasing some of your personal assets.

Remortgaging your home

For many people, the value of their home is substantially greater than the outstanding mortgage. As a result, remortgaging has become a popular and relatively cheap way to raise long-term business finance.

It's worth talking to your mortgage provider if you're thinking about remortgaging. You may find they're willing to negotiate on interest rates, rather than risk losing your business.

If you do have to move your mortgage there could be penalty costs involved. You may also

CASE STUDY Using savings to start up

Paul Kruzycki carried out 18 months of meticulous research to find out that his new real-ale mail-order company, Ales by Mail, couldn't pay him a salary at first. He worked out he needed to save at least six months' living expenses before taking the plunge. "I knew I needed to cover my portion of the household expenses," says Paul, "and some luxuries had to be put on hold, such as holidays."

Redundancy money from his job as a building surveyor helped. Paul split the money, putting half into an emergency fund and setting aside the rest to pay the family's expenses while the business got off the ground.

A lucky opportunity also came up allowing him to work as a property consultant part time. "I now do that two days a week and spend the rest of the time on Ales by Mail," explains Paul.

This approach continues to work well.

have to cover valuation, legal costs and arrangement fees. It's definitely worth shopping around – there are fee-free remortgage options on the market. There are many commercial organisations that offer guidance on mortgage rates, or you can contact the **Financial Services Authority** for independent advice; for their website, see 'Where to go Next'.

Remortgaging is not a decision to be taken lightly as you're putting your home at risk. Experts also advise against using up all the available equity in the family home. Look at a partial remortgage. Releasing just part of the equity in your house could make an important contribution to your business.

Self-financing

Pros

- You don't have to convince others to invest
- If you're using existing funds, you're not tied in to loan repayments or interest charges and you can spend money how you want, without having to justify decisions to external investors
- It will stand you in good stead with financiers later if you need further investment

Cons

- If you use up all your savings you may have no emergency cash fund left to fall back on. Experts advise keeping a reserve to cover at least three months' worth of expenditure
- If the business does not perform as expected, your personal assets are at risk. For example, if you remortgage your home and can't make the repayments, it could be repossessed

WHERE TO GO NEXT

- For more on raising funds while your business gets started:
  Business Link
  www.businesslink.gov.uk/startupfinance
- For independent advice on mortgages:
  Financial Services Authority
  www.fsa.gov.uk/consumer/07_MORTGAGES/index.html
- To compare the latest bank rates:
  British Bankers' Association
  www.bba.org.uk

"I don't wish to give up any control of my company, but don't mind taking on debt. What should I consider when approaching the bank?"

Getting finance from the bank

Before you approach your bank for a loan or overdraft, prepare your case. We show you what to look out for and how to keep the costs down

IN A NUTSHELL

- First work out what the money is for and how long you'll need it
- Make your case to the bank with your business plan, putting your own money into the project and by providing security
- Short-term costs are usually best met with an overdraft, long-term with a loan
- Shop around and negotiate to get the best deal; get everything in writing
- Study the small print

Seventy per cent of small businesses call on their bank to borrow money. Banks offer long-term finance in the form of loans and mortgages, and short-term finance through authorised overdrafts. But before you approach your bank, you should first work out why you need the money and for how long.

For long-term purchases – new machinery or premises, for example – then a loan or commercial mortgage may be best. Leasing or hire is another option if it's equipment you need; for more, go to pages 20-21.

Short-term day-to-day running costs (such as buying stock, or tiding you over until cash comes in from a customer) are often best met by authorised overdrafts or short-term loans.

When looking at these options, obtain written quotations for each, so you can accurately compare total costs, including bank charges.

Loans

If you need the money for more than a year, for a specific purchase or planned expenditure, a loan is a good solution. You agree to pay back a set amount each month over a specified period. For long-term borrowing they can be cheaper than overdrafts. The interest rate will vary depending on your business, size of loan, security available and other factors, but may be on average around 2-3 per cent above the base rate. As repayments are scheduled, a loan lets you plan your budget.

Pros

- Repayments are straightforward and so can be planned and budgeted for in your forecast
- You don't have to relinquish any control over the business
- A loan can cost you less in interest payments than an overdraft over the same term, particularly if the overdraft does not fluctuate and fees are taken into account
- You may get tax relief on interest repayments

Cons

- Being locked in a rigid repayment schedule can be a problem if your cashflow is erratic
- You may need to put up security against the loan, such as a business or personal asset – see the Security – Will I Need It? box for details
- Banks can be reluctant to lend money to new business owners with no track record
- If you want to repay the loan early you may have to pay a redemption penalty

Overdrafts

For a short-term lack of cash, overdrafts are a popular solution for many businesses.

Further advice
For advice on producing an effective business plan **pages 10-11**

Pros

- Flexible – you only pay interest on the amount of money you use
- It may be quicker to arrange than a loan

Cons

- The bank can call in an overdraft at any time
- You may still have to provide security
- If borrowing to fund a long-term purchase, an overdraft will probably cost more than a loan
- If you exceed your overdraft limit, you could pay high interest rates and penalty charges and your cheques could be bounced
- Overdrafts have to be reviewed regularly

For more on **loans and overdrafts**, visit **www.businesslink.gov.uk/bankdebt**

Costs involved

Whether you choose a loan or an overdraft the amount you pay back depends on the interest rate charged, the amount you have borrowed, plus any fees or repayments. The interest rate will be fixed or variable. With a fixed rate, the interest remains constant throughout your repayment period. With a variable rate, the interest fluctuates with changes to the Bank of England base rate.

Repayment schedules can run from one to 15 years; the longer the payback period the more interest you'll pay (but the monthly repayments will be lower). When comparing different loans and overdrafts, look at the annual percentage rate (APR). This is the rate it will cost annually once all charges are accounted for.

Check the small print for hidden costs. For example, if you want to pay the loan off early, are there penalty charges? Do you need payment protection insurance?

What the bank looks for

Stephen Pegge, chairman of the small firms panel for the British Bankers' Association, says

SECURITY – WILL I NEED IT?

The bank's overriding concern is that it gets its money back, and that's why it might insist that a loan or overdraft is secured.

Stephen Pegge, chairman of the Business Bankers' Association small firms panel, says security is not necessarily needed for smaller loans, but is for larger amounts.

If your business is a new company, banks will usually need personal guarantees from the backers of your business, such as directors and other shareholders. Existing businesses often use assets as security; this can be equipment or premises. If the business closes or you sell the asset, the bank has first call on the proceeds. If you are a new company, you may have to rely on personal assets, such as property, to support your guarantee. Of course, this means if the business goes under you could be forced to sell your home.

Another option is to get a third party to guarantee your loan. If you have no security you can look into a Small Firms Loan Guarantee. The Government guarantees 75 per cent of the loan, in return for an annual premium of 2 per cent. UK businesses that have annual turnovers under £5.6m and are less than five years old are eligible. For more details, visit www.businesslink.gov.uk/sflg

More security reduces the lender's risk and you may get a better interest rate, so try to negotiate based on your available security.

CASE STUDY Successful banking relationships

Helen Colley spent five years growing the premium dessert business, Farmhouse Fare Ltd, which was recently acquired by Daniel's Chilled Foods. Initially the business was funded by the sale of her existing catering firm, a grant from the Rural Enterprise Agency and a bank loan.

"I went to the bank with an excellent business plan, developed with the help of my local Business Link, and convinced them to provide initial funding," she says.

Helen describes her working relationship with her bank as "superb". "The key was providing regular financial information. It also helped that we always managed to exceed budgets, too," she says.

banks look at three key areas when deciding to say yes or no to a loan or overdraft request.

"The key factor is the person asking for finance, the impression they make and their record as a business or personal customer. We then look at the business and the business plan. Then the proposition: will the investment generate sufficient cashflow to repay? This becomes more crucial the bigger the deal is in relation to the size of business and the amount of experience the prospective borrower has."

Other factors banks look at when deciding whether or not to lend you money include:

- **Your business plan:** The plan should include details of how you plan to repay the debt. As Stephen Pegge explains, the level of detail depends on your circumstances: "If there's a secondary income, such as wages from a spouse, or the risk is relatively low, we wouldn't expect a great deal of detail. But if it's for a large sum or we're dealing with someone new to the bank, we often want more information."
- **Security:** You may be asked for some kind of security, particularly if the loan is over £25,000 or if you're a new business. See the box on page 15.

- **Money from you:** You can demonstrate your commitment by investing your own money
- **Your track record:** If you already have an account with the bank (either business or personal), have you borrowed and repaid earlier loans or overdrafts?
- **Profit and trading history:** Existing businesses may have to show the last three years' accounts for historic performance details
- **Credit rating:** To see the information credit reference agencies hold about you, contact Experian by visiting www.uk.experian.com

Getting the best deal

New business owners often turn to the bank that holds their personal account when finding funding, but you should compare charges from at least four banks (for example, how much does it cost for cheques, deposits, standing orders and overdraft facilities).

If you're already trading, changing banks is now much easier than it used to be and it could save you money. For more advice, read our guide to transferring your business account at www.businesslink.gov.uk/switchbanks

Find out about the banks offering business banking

Further advice
For advice if considering borrowing from friends and family pages 18-19

CLAIM TAX RELIEF ON LOANS AND OVERDRAFTS

You can get tax relief on overdrafts and loans. If you're a sole trader or partner, any interest you pay on a loan for business purposes is deductible against your taxable profits. If you take on a loan to invest in your business, you get tax relief at your highest rate of tax on the interest you pay. For more details visit **www.businesslink.gov.uk/taxdeductions**

accounts, the services offered and the charges at the British Bankers' Association business account finder at **www.bba.org.uk/bba/jsp/polopoly.jsp?d=142&a=225**

Many banks offer free business banking for a set period, but find out what charges apply after the introductory period. Ask what 'free banking' means – it may be free only if you're in credit or your turnover is under a certain figure.

When choosing a bank ask these questions:

- **What support is offered?** Do they have a dedicated small business team, will you be allocated a specific adviser and is there support material, such as free websites and guides?
- **What services do they offer?** For example, do they offer internet or telephone banking? If so, do they charge for this?
- **How are charges levied?** Is there a fee per transaction or a one-off charge?
- **How close is it to your premises?** If you're likely to have a lot of transactions requiring you to visit the bank, then proximity is a key issue

How to keep banking costs down

- **Negotiate with your bank manager:** Everything is negotiable, from overdraft interest rates and charges to loan repayment schedules. Get any special terms in writing
- **Reduce transactions:** Try to avoid cash and cheques. Automation – direct debits, standing orders, internet banking – tends to be cheaper
- **Review charges regularly:** Ask your bank manager to suggest how to reduce charges
- **Earn interest:** If you have extra funds, put them in a high-interest deposit account. For tips on **negotiating with banks** visit **www.businesslink.gov.uk/banknegotiations**
- **Make sure the charges are correct:** Check any discrepancies between statements
- **Avoid unauthorised overdrafts:** Monitor your account using telephone and internet banking

What to do if the bank says 'no'

One in 10 business loan applications are rejected. If this happens, find out why, so you can then revise your plan and try again.

Non-bank capital is also available. The Community Development Finance Association has a list of possible sources, with funding usually dependent on the owners being from certain communities, their age and location.

WHERE TO GO NEXT

- Loans at preferential rates to young entrepreneurs (18-30 years old):
  Prince's Trust
  www.princes-trust.org.uk
- Find out about your credit history:
  Equifax www.equifax.co.uk
  CallCredit www.callcredit.co.uk
- For information on funding for Social Enterprises:
  Social Enterprise Coalition
  www.socialenterprise.org.uk
- For community development finance:
  CDFA www.cdfa.org.uk

"My family are supportive of my business idea and would consider making an investment. How can I best ensure this runs smoothly?"

Investment from friends and family

Owners of new or trading businesses often get funding from friends and relatives. This can be successful, but there are some potential pitfalls

IN A NUTSHELL

- **Decide what the money is for**
- **Be honest with potential investors**
- **Put the agreement in writing**
- **Get professional advice**

Family and friends are a cost-effective, popular and flexible source of both short and long-term finance. According to the Family Business Network up to 75 per cent of UK businesses are funded in this way.

While family members tend to be more flexible on interest rates and security than the banks, they shouldn't be seen as a 'last resort' funding choice. If the bank won't put money into your idea, are you really prepared to let your family invest? Be honest with them about the potential risks involved, if your business fails your family may lose their money.

What do you need the money for?

Before you approach your family, you should be clear about what you want the finance for. If it's for short-term use – to keep your new business afloat until your customers start paying your bills for example – then the best option is probably a loan from friends and family.

You then need to decide what interest you're going to pay on that loan and work out a fixed repayment period. Family and friends may be flexible here; they could allow you to pay by instalments or at the end of a fixed period. They might even accept 'repayment in kind'; for example, if you're running a shop perhaps they could receive goods from the store.

If you need the money to carry out long-term plans, such as buying equipment, think about selling a share of your business in return for funding. You would then need to think about how much involvement you're willing to give them in the running of your company.

For more guidance visit www.businesslink.gov.uk/familybusiness

What's in it for the investor?

Think about the deal from the investor's point of view and work out the benefits for them. For example, can you pay them a better rate of interest than they are currently getting

INTEREST-BEARING AND INTEREST-FREE LOANS

There are two types of loans:

- An interest-free loan is less likely to have tax implications for either you or the lender
- Interest-bearing loans usually have tax implications for both parties. You can deduct loan-interest for business purposes when calculating profit. Lenders must declare interest received as taxable income

For more advice, contact your local tax office by visiting **www.hmrc.gov.uk/local**

CASE STUDY Turning family into shareholders

Tom Allason and Jay Bregman needed £500,000 to help develop vital technology to get eCourier, an online courier business, off the ground. "Our problem was we didn't have a track record," admits Tom. "The banks weren't going to lend us money."

Getting the first £100,000 to finance initial development was key and this eventually came from Tom's stepfather. "He agreed to invest £100,000 on the basis that we raise another £400,000," explains Tom.

But Tom's stepfather was no pushover, he wanted a full business plan with detailed financial forecasts. His investment was crucial and helped Tom and Jay secure a further £200,000 from friends.

In return for the money, they've had to give up 49 per cent of their business in shares, but Tom says: "It was important to get used to the idea that it was much better to have a small slice of something big than a big slice of something small."

from a bank savings account? If they invest in the business, when can they expect to receive a share of the profits and how much is that share likely to amount to?

Friends and family finance

Pros

- They know you as a person, and may devote more time to understanding your business plan
- They may require less security, lower interest and more flexible repayments than a bank
- You keep the profits within your family

Cons

- There is a possible danger of family conflict if the loan details are not clearly understood
- If the venture fails, investors may lose money
- Family members may want involvement with the day-to-day running of the business
- They may need to request access to their money sooner than you had both planned

Avoiding the pitfalls

Be honest with friends and family. If the bank turned you down for a loan, you will need to pass on the reasons why they rejected your application, and you should both study the business plan objectively. Don't persuade them to lend or invest more than they can afford to lose. Both you and they should get professional advice before you do the deal; for more about **advisers**, go to **pages 8-9**. Put any agreement in writing; do not rely purely on trust and verbal assurances. The agreement should spell out:

- The nature and timing of return on the investment, and the repayment schedule – including dates, amounts and interest
- Respective responsibilities, such as whether the investor will have a role in the business
- What happens if your company goes under
- What happens if you fail to keep up with the repayment schedule

For advice on **loan agreements** go to **www.businesslink.gov.uk/loanagreements**

WHERE TO GO NEXT

- For further advice on family businesses and the issues the can face:
  Institute for Family Business
  www.ifb.org.uk

"I need expensive equipment to produce my product, but I don't want to use up all of my capital buying it. What are my options?"

To buy, lease or hire equipment

Buying may not be the best use of your cash, especially as leasing or hiring can help free more working capital for your business

IN A NUTSHELL

- Think about lease or hire if the item has high maintenance costs or quickly becomes outdated
- If you expect the item to appreciate in value, work out if it's better to own it outright rather than hiring or leasing
- Consider hiring items that are only needed occasionally

At some point, usually at the opening stages, you'll need equipment or other assets to help run your business – but should you buy, lease or hire them?

Buying items outright sounds the simplest option; cash purchases often work out cheaper in the long run and the goods are classed as business assets, so can be used as security. But be sure this is the best use of your working capital and won't cause cashflow problems.

If you haven't got the cash available upfront but you still want to own the item, you may decide to take out a bank loan or overdraft to cover the cost of your purchase. Include the interest repayments in your calculations and compare the result against hire or leasing costs before making your decision.

If you don't need to own the item, consider leasing or hire. Monthly costs are fixed, so you get greater control over your budget and it's a sensible choice if the asset is likely to need replacing quickly to keep up with your market (for example, specialised technology).

WHAT'S BEST FOR YOUR BUSINESS?

Option	Good choice if:
Buying outright	• You need to own the item • You have the funds in place for purchase
Leasing	• You don't need to own the item • There are costly maintenance or insurance costs that are covered by the leasing contract • You don't have the necessary funds in place to buy the item outright • The asset has high maintenance costs or becomes out of date over time
Hire purchase (HP)	• You want to own the item eventually • The HP interest rate is cheaper than the interest on a loan or overdraft you would need to take out to buy the item outright
Hire	• You only need to use the goods occasionally

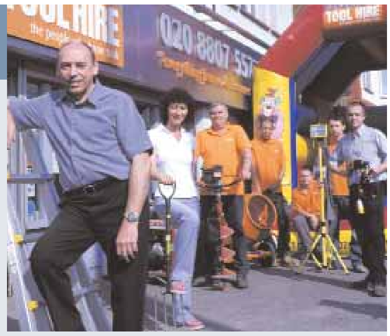
How leasing works

Leasing details vary from company to company but generally they fit into two categories. One of the most popular methods is direct leasing. With this, you decide what asset you need and arrange for a leasing company to buy it for you on your behalf and then rent it out to you.

The second option is purchase leaseback, where you sell an asset you already own (a vehicle, for example) for a fair market value to a leasing company and it then leases it back to you.

Further advice
For tips about improving your business's cashflow pages 26-29

CASE STUDY Mixing buying and hiring



Alexandra Tool Hire Ltd provides hire tools and equipment. They need a wide range of equipment to hire out to customers – an expensive upfront cost. When they originally started, this was financed through a conventional business loan from the bank. However, when they needed two trucks, they decided to use hire purchase (HP). Managing director Bob Rist explains: "We got the trucks on HP as it made financial sense to us. The agreement runs for three years, after which we own them. We claim the payments as a business expense and can recover the VAT on them."

In both of these cases you pay for the asset in regular instalments over a fixed period, typically one to five years. You will either have to return it to the leasing company at the end of the lease period (but can request that your business has exclusive use of the asset), or can arrange ownership for a nominal amount.

If you don't want the complications of maintenance and insurance costs, investigate contract hire. This is often used with vehicles, including extra services, such as maintenance, insurance and repairs, in the monthly costs.

If you want to own the goods, but can't bear the full cost upfront, consider hire purchase (HP) – a way of buying goods on credit. You're charged interest for the period of the agreement and are usually responsible for the asset's maintenance. However, before you go for HP, compare the costs of getting a bank loan or overdraft to buy the asset outright with the total cost of paying for the goods on HP.

Finally, if you will need certain equipment for your business but will only need to use it occasionally, hiring the asset out on an as-needed basis could prove to be the most cost-effective choice for you.

Tax and VAT implications

If you buy items – either outright or by HP – you may be eligible for capital allowances, which let you offset the cost of some of your assets against taxable profits. With HP, the capital allowances are calculated in the same way as if the asset was bought outright, using the base cost of the asset, excluding the HP interest element; relief for HP interest paid on business assets is allowable in the profit and loss account. For more on **capital allowances**, visit **www.businesslink.gov.uk/capitalallowances**

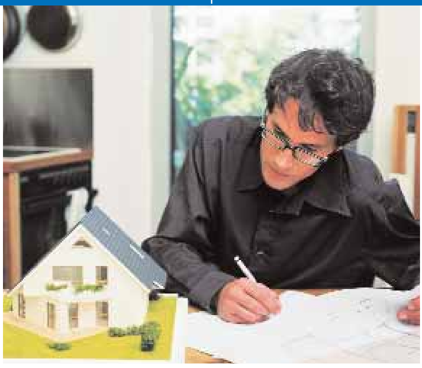
Although you can't usually claim capital allowances with leasing or hiring, businesses can deduct the full cost of the lease/hire fees paid from the taxable income as a trading expense. The position changed in 2006 for some leases over five years, so take professional advice if you're considering financing in excess of five years.

If your company is VAT registered, you can claim back VAT on the payments for HP, hire and leasing. For more on tax and hiring/leasing visit **www.businesslink.gov.uk/taxdeductions**

WHERE TO GO NEXT

- For further details about leasing options from various companies: **Finance & Leasing Association www.fla.org.uk**

"I would like to own my own business premises, rather than pay rent – what is available, and how can I find the best deal for my business?"



Premises – buy or rent?

Business owners often choose to rent property, but buying may make more financial sense

IN A NUTSHELL

- Shop around for the best deal
- Fixed rates are good for budgeting
- Seek expert advice to ensure you choose the most tax-efficient option

Before deciding whether to rent or buy your premises, weigh up the costs of each option over time and get expert advice. Your accountant can help and advise you on the most tax-efficient option.

Should you buy your own premises?

Pros

- The property could provide income if you sub-let part of it or let all of it in the future
- Mortgage repayments are likely to be less than rental payments on the same property
- You're not exposed to hefty rent increases
- Interest payments on a commercial mortgage are tax deductible
- Greater flexibility over building management

Cons

- You'll need a considerable deposit
- You have to shoulder the burden of additional responsibilities, such as maintenance costs and building insurance

Getting a commercial mortgage

If you decide to buy, the most popular financing choice is a commercial mortgage; this is simply a loan for a property that's used for business. You could use a mortgage broker to help you get the best deal. They will negotiate with lenders on your behalf.

Commercial mortgages are a flexible and affordable option, but have their downsides. For example, the lender has a legal claim over the property until the loan is repaid and, in the event of non-payment, it can be repossessed.

Lenders will look at the operating and credit history of your business to work out how much money to lend. They'll want to see the last three years' accounts and may also ask for a business plan and personal status references.

Typically lenders offer a minimum of £25,000 for up to 30 years, funding an absolute maximum of 85 per cent of the purchase price.

The interest rate and terms you're offered will be based on your business plan, historic business performance, the size of your deposit and the security you're able to offer.

MORTGAGES: WHAT TO LOOK FOR

- Interest-only periods to improve cashflow
- Upfront lender and broker fees
- Penalties for paying off the mortgage (all or in part) early
- Closing costs you might run up before ownership of the property passes to you – these include legal and site survey fees
- Compare the Annual Percentage Rate (APR) which reflects the total borrowing cost not just the interest rate charged

WHERE TO GO NEXT

- For advice on the types of business best suited to commercial mortgages: **www.businesslink.gov.uk/mortgages**

"I have heard about financial assistance available for new businesses. What might mine be entitled to?"

Is my business eligible for a grant?

There may be government cash to help you – if you know where to look

IN A NUTSHELL

- Your local Business Link office can advise you on grant eligibility and government allowances
- Grants tend to be for new projects
- You will probably have to part-fund the project yourself
- You also need costings and project information before you apply

A grant is money given to a new or existing businesses for a specific project or purpose. For example, The Prince's Trust [visit www.princes-trust.org.uk] awards money to young entrepreneurs aged 18-30 to help start new ventures, while other agencies fund new projects, such as moving into export, for existing businesses. Across the various schemes in the UK, there's £5bn worth of development capital available annually.

Grants give a cash influx you don't have to repay, and you don't have to give up a share of your business. But finding schemes is tricky, the application process can be slow and competitive, and the criteria are stringent.

Who hands out the money?
There are more than 1,500 UK business grant schemes including those from the Government, the EU, Regional Development Agencies, local authorities, Chambers of Commerce and County Enterprise Boards. To find out what grants are available in your local area, visit the Business Link grants database at www.businesslink.gov.uk/support/. You'll be asked a few simple questions and they'll tell you about appropriate schemes available in your area. They can also help with other services such as training courses.

Grant eligibility
Grants are almost always for proposed projects, not ones already under way. Specified purposes include starting up a new business or opening a branch in an area that needs economic regeneration, researching new products and website development.

There are strict terms and conditions that apply to grants. If they're not followed you may have to pay back the money.

You can expect to get between 15-50 per cent of the total costs of the project funded by a grant. This means you will need to find money from alternative sources to cover the shortfall.

Applying for grants
Your local Business Link office will help identify relevant European, national and local grant schemes, and will contact them to check your

CASE STUDY Getting a website grant

Daniel Smith set up Tours4, a company organising sporting trips across Europe, in 2005 with his business partner Sam Jennings. Both were straight out of university, so they looked for advice from every source they could find, including the The Prince's Trust, local councils and Business Link, which suggested they apply for a web development grant.

"We were given a list of six Business Link authorised web designers to work with," explains Daniel. "I went to see each of them and got quotes. We chose a company that took us through every step of the process."

Business Link were happy with the quote and offered to contribute £1,600 towards the costs.

"If you don't ask, you don't get," says Daniel. "We've asked for discounts, free advice and grants. As a result, we've saved a lot of money."

eligibility. Before you apply, you'll need to provide the following:

- The project's details and its potential benefits
- A comprehensive work-plan with full costings
- Your and key managers' relevant experience

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

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 there are no matched funds from the applicant, or if it's unclear how important the funds are to the project's success. Andrew Diggle, a director of a grant search company, cautions small businesses to exercise restraint even if they do get grant funding: "The money will take a while to come through (anything from weeks up to a year) and you won't be reimbursed for payments you make beforehand."

Other government allowances

Your business could also be eligible for other government schemes. For example, there's a range of **tax allowances** for new businesses, including capital allowances for investment in equipment and premises (so you can deduct a proportion of these costs from your taxable profits over several years) and stamp duty relief in disadvantaged areas. Visit **www.businesslink. gov.uk/taxbreak** to see a checklist of the tax advantages available for new businesses.

Tax credits and tax allowances may also be available for businesses to research and develop new products, processes or services. Visit **www.inlandrevenue.gov.uk/randd/**

You could also be eligible for **non-financial support**, such as free business planning courses, networking events and bookkeeping training. Visit **www.businesslink.gov.uk** for more details of these services. ■

WHERE TO GO NEXT

- For more details on where to go for grants and other types of support for your business :
  Grants and Support Directory:
  www.businesslink.gov.uk/support

Attracting investors

Swapping a stake in your company for investment can really help it grow

IN A NUTSHELL

Equity funding could be for you if:
- **You're prepared to give up a share of your business and its profits**
- **Your business can support a significant high growth rate**

Equity investors put up money in return for a share in a business. This means you don't need security and may not have to repay the cash – investors hope to get their money back, plus profits, either by selling shares or through dividends. Disadvantages are that you'll have to relinquish some control over your company (investors may want a seat on the board) and give up a share of your profits.

Potential investors will want details of possible exit routes from the business, so they can see how they will eventually be able to release their investment, plus profits.

Where and when to get equity finance

Many small businesses launch with funding from friends and family; for more detail, go to pages 18-19. This may be an equity arrangement, where they take a stake in your business. Alternatively, you could approach investors such as business angels – these are wealthy individuals who typically invest between £10,000 and £750,000 either alone or as part of a syndicate.

Equity funding is suited to all stages of development. Business angels typically provide cash in the early stages but they can also help, for instance, if an existing business needs further funding to develop a new product.

What type of companies get funding

High growth is the key; if your business can't support significant high growth rates, you may not be able to attract equity funding. Business angels are also looking for products with a competitive edge; companies with an effective management team; an exit route with a strong return on their investment; and for businesses matching their sector preferences.

What else angels offer – and how to find one

Business angels can do more than just provide money. They're often experienced entrepreneurs who can help you plan or run your business. They may have valuable business contacts, or they could help you develop your own management skills. The British Business Angels Association (www.bbaa.org.uk) can help you find a suitable investor. For more on equity finance, visit www.businesslink.gov.uk/equity

If you need a larger investment, or to read more on angels, see the No-Nonsense Guide to Finance for High Growth Companies. ■

CASE STUDY Business angels

Specialist technology company d3o Lab developed a new shock-absorption material that they wanted to produce and sell. Founder Richard Palmer needed funds to exploit the opportunity: "We needed a substantial investment without ceding too much day-to-day control, so angel funding was ideal."

Improving the flow of money

Getting the money rolling in promptly is vital; it can make all the difference between a business that just gets by and one that thrives

IN A NUTSHELL

- Get your invoices out straight away
- Agree credit terms with your suppliers
- Implement just-in-time stock control systems
- Depending on your business type, you can get a third party to advance money against your debts (factoring)
- Reduce overheads by leasing equipment

Cashflow management – the flow of money into and out of your business – is a key priority for any small business. The Federation of Small Businesses estimates a quarter of all business failures are the result of interruptions to cashflow.

You might have plenty of orders coming in but if you're regularly short of cash to cover monthly necessities, such as staff wages, you have got a cashflow problem. Maybe you are late getting your invoices out, or customers pay late, or you have too much money tied up in slow-moving stock. Whatever the reason, it needs to be identified and addressed.

Get the money rolling in quicker

Late payment is a big concern for small businesses. It's estimated that small and medium-sized businesses are owed £17bn from debtors at any one time, and approximately 10,000 UK businesses fail each year due to late payment.

The key to getting money in promptly is to send your invoices out as soon as possible and set up an effective credit control policy.

■ **Do your homework on new customers:** Before even the first sale, take the initiative and ask your new customers to complete a credit application form. The information you

CASE STUDY Growing the business through factoring

Haulage firm CJ Express has been using factoring services since 1997 and operations director Cath Cooper has found it a very cost-effective way to grow.

"Nine years ago factoring was fairly new and it was frowned upon by many people," she says, "but we were a small business and we needed to grow. As a haulage firm, our costs were due within 14 days (mainly wages and fuel) but our customers were paying within 30 days at the earliest. The money just wasn't in the system to finance growth."

The company decided factoring was the way to go. Not only did the service allow the business to grow rapidly, it meant the factors chased up bad debts. "That's one less person we need to employ in-house," says Cath.

The relationship has worked well for CJ Express. The company now has a turnover over £1.7m and has moved to new premises.

Further advice
For tips on dealing with financial problems pages 30-31

collect should include full name and trading address, invoice address, name and address of two trade references, company registration number, the names of the directors of the business and the length of time the business has traded

- **Set a credit limit for each customer:** Try putting a cap on the amount of money they are allowed to owe you
- **Draw up clear payment terms and conditions (T&Cs):** Put your T&Cs in writing and draw your customer's attention to them before the sale. Make it clear you expect payment within 30 days
- **Use the Late Payment Law to your advantage:** You could incorporate the Late Payment Law into your T&Cs. Under this legislation you can charge interest on late payments owed to you. You might feel that this would make you unpopular with your customers, but the legislation can be used as an effective deterrent by incorporating it into your T&Cs, so customers understand upfront that they can't pay bills late without invoking some kind of penalty. For more on how to calculate interest on late payments, visit **www.payontime.co.uk**

Cath lauds factoring as a more cost-effective way to finance business growth than bank overdrafts. "The key is to do your research and make sure you forge a good relationship with the factoring house."

- **Get the order in writing:** When a sale is made, ask for an official purchase order (PO). It can speed up the payment process and some companies won't pay unless you've got a PO number. If they don't do POs, issue an order confirmation and get the customer to sign and date the document
- **Get your invoices out quickly:** Send your invoice with the goods. Don't wait until the end of the month, as you could find yourself falling into your customer's next cheque run
- **Chase debts promptly and firmly:** Once an unpaid invoice is overdue – a week is usual – you need to put some kind of debt recovery process into action. Try the three-stage approach – first, a polite phone call asking when you can expect to get the overdue payment. Second, a warning by letter saying that if payment is not received within a week you'll be forced to place it in the hands of a solicitor. In the last stage you tell the customer you've put the matter in the hands of a solicitor. Log every effort you make to chase payment. You should also stop supplying goods or services to the customer if they haven't paid by a set time after the due date specified on your invoice
- **Raise prices for those customers that habitually pay late:** One in four UK businesses have done this, according to research from the Better Payment Practice Group (BPPG). Professor Robin Jarvis of the BPPG says: "Suppliers shouldn't be afraid to use sanctions such as higher prices (where commercially viable) or statutory interest, to enable them to protect their own balance sheet"

Other techniques to get earlier payments

You can persuade customers to pay invoices quickly by offering discounts for early payment, or encourage staged payments if you're

"My customers don't always pay their invoices on time, but I need the money to keep my business running – what are my options?"

MONTHLY FACTORING COSTS (based on £300,000 turnover)	
Monthly invoices to client	£25,000
Factor advances 85 per cent of invoice value	£21,250
Reserve held by factor for security	£3,750 (A)
Clients pay invoices in full	£25,000
Factor service fee at 1 per cent	£250 (B)
Monthly interest on advance at 6 per cent	£106.25 (C)
Amount already advanced	£21,250
Additional amount paid to you	£3,393.75 (A–(B+C))

Leasing rather than buying equipment

Consider leasing fixed assets (equipment) or buying them on hire purchase. Buying outright can result in a huge drain on cash, particularly in the first year of business, and leasing makes it easier to update equipment.

For more on the **pros and cons of leasing**, go to **pages 20-21**.

working on a large order. And if you're dealing with staged payments, you could also set up a direct debit or, if you're in the service industry, try negotiating a retainer.

Managing your relationship with suppliers

Ask suppliers for discounts for paying invoices early, or agree staged payments to smooth out your monthly cashflow. For more on **managing supplier relationships**, go to **www.businesslink.gov.uk/suppliers**

Order less stock more often

Holding too much stock can tie up cash that may be better used on other expenses. In addition, extra stock can be expensive to store.

Look at ordering tactically – order items in smaller amounts but more often. This is an efficient and flexible option as you only have what you need when you need it. It also means you're free to update and change products quickly without wasting existing stock.

For more details on **efficient stock control**, visit **www.businesslink.gov.uk/stock**

Raising money against your invoices

One way of ensuring you have a consistent cashflow is to outsource the process of invoicing altogether. Outstanding invoices are seen as business assets and you can release the cash immediately, without having to wait for your customers to pay you, by using businesses that specialise in advancing money against your invoices – factoring and invoice discounting companies.

How factoring works

Essentially a factor gives you a flexible form of loan; they advance money to you as you issue new invoices. A factor will collect the invoice payments on your behalf, paying 80-90 per cent of the invoice amount when it's issued and the remainder when the customer pays them.

Factoring is becoming increasingly popular. The Factors and Discounters Association reveal that £117bn of invoices were assigned to factors in 2002, and that figure is going up every year.

The big benefit is the amount of money that is advanced grows as your business grows. It also speeds up your cashflow by removing the time lag between issuing an invoice and getting paid.

Factoring doesn't work for all businesses though. It's particularly suited to sole traders, partnerships and limited companies selling goods or services on credit to other businesses and those with a spread of customers.

Many temping agencies use the services of a factor to smooth out cashflow problems. Temps have to be paid weekly, but it invariably takes much longer than that for the businesses using the temps to pay the agency. Factoring allows the agency to pay the salaries, while the factor chases the debts from clients.

Factors charge two basic fees – a service fee and interest on the amount advanced. The service fee is the cost of outsourcing the management of chasing payment of invoices. It is usually charged as a percentage of your turnover – this is generally between 0.5-3.5 per cent. Most businesses would expect to find themselves falling within the 1.25-2.5 per cent bracket.

The factor also charges interest on the amount of your invoices they advance, typically at interest rates 2-4 per cent over base rate. This compares favourably with the cost of an overdraft; see the Factoring Costs box on page 28 for more.

Many businesses find factoring to be a cost-effective means of evening out cashflow. The factor is running the credit control system on their behalf, so they don't have to run their own credit control department. But make sure you inspect the small print before you sign up: find out how long you're tied into a contract (usually between between six and 12 months) and find out whether there are any penalties for getting out of the contract early.

How invoice discounting works

Invoice discounting gives you the cashflow benefits of factoring but you raise and chase invoices in the usual way. You send out invoices as normal and send a list of them to the discounter. The discounter then pays you up to 85 per cent of the invoice value. You collect the payment and put the money into a trust bank account. The discounter then takes the cash from the account and releases the 15 per cent balance, minus their charges.

The charges will vary, but typically they would include a service fee, calculated as a percentage of your turnover (usually somewhere between 0.1-1 per cent). In addition to this they will levy an interest charge on the advanced funds – this is usually 1-2.5 per cent over the base rate.

Invoice discounting is generally cheaper than factoring and you stay in control of the invoicing procedure. However, you will need recent accurate accounts and be able to prove you can successfully run your own sales ledger.

Finding a factor or invoice discounting service

Most banks have factoring arms or should be able to recommend a reputable company. You can also try the Factors and Discounters Association website (www.factors.org.uk). Be warned, companies differ in how they calculate interest payments. Some calculate daily, others monthly. This will affect your charges. Read our guide on how to choose a factor at www.businesslink.gov.uk/choosingafactor

WHERE TO GO NEXT

- For case studies on how factoring can help improve cashflow:
  Finexia
  www.finexia.com/html/case_studies.html
- For credit management advice and free guides to getting paid on time:
  Better Payment Practice Campaign
  www.payontime.co.uk

Solving funding problems

Address your money concerns when they arise

The problem	Possible solutions	Where to go next
I'm always overdrawn	If you suffer from late-paying customers, try borrowing by using a factoring or invoice discounting service	Read up on how factoring and invoice discounting works on p26-29 and at www.businesslink.gov.uk/factoring
	Look at replacing the overdraft with a loan – it can be a less expensive solution	The benefits of loans as compared to overdrafts can be seen on p14-17 and at www.businesslink.gov.uk/bankdebt
	If you're overdrawn because you're buying new equipment you could look at leasing or hire to ease cashflow	For advice on deciding whether to lease or buy go to p20-21 and visit www.businesslink.gov.uk/lease
I'm spending all the money the business makes on overheads	Reduce expensive equipment overheads by leasing or hiring assets	For more on the pros and cons of leasing and hiring go to p20-21 and visit www.businesslink.gov.uk/lease
	Consider hiring the services of an accountant who can help assess your business spending	For more on choosing an expert adviser go to p8-9 and visit www.businesslink.gov.uk/advisers for tips on finding a good accountant
	Maybe you are underpricing your products or services. Check your prices and margins against your competitors	Read our guide to How to Build a Pricing Strategy at www.businesslink.gov.uk/pricing
All my money is tied up in stock	Negotiate with suppliers to get them to buy back stock at cost price to cut down on stock levels	Read our guide to How to Manage Suppliers at www.businesslink.gov.uk/suppliers
	Move to Just-In-Time ordering, so you only get stock in just before you need it	Read our guide to Stock Control Levels at www.businesslink.gov.uk/stockcontrol
Late payers are causing cashflow problems	Try to negotiate staged or upfront payments; issue your invoices promptly and chase debts efficiently	For more on dealing with late payers go to p26-29 and for advice on getting paid on time visit www.businesslink.gov.uk/gettingpaid
	Investigate borrowing against your invoices by using a factoring or invoice discounting service	For more on factoring see p26-29 or visit www.businesslink.gov.uk/factoring
My money runs out before clients pay up	Set up a clear and prompt invoicing system	For more on ensuring customers pay early, visit www.businesslink.gov.uk/invoicing
	Request payment for materials in advance, or negotiate staged payments	Read our guide to How to Deal With Slow Payment From Customers at www.businesslink.gov.uk/gettingpaid
	Renegotiate terms with your suppliers	Read our guide to Negotiating The Right Deal With Suppliers at www.businesslink.gov.uk/dealwithsuppliers

Further advice

For guidance on finding a financial adviser pages 8-9

The problem	Possible solutions	Where to go next
Money is always really tight during the summer months	Consider seasonal variations in your business planning by putting surplus cash into high-interest accounts	Read our Advice For Seasonal Businesses guide at www.businesslink.gov.uk/seasonalbusiness
	Keep a core of full-time staff and take on casual staff to cover busy periods	Read our guide to Getting The Right Staffing Levels at www.businesslink.gov.uk/seasonalstaff
My accountant costs too much	Consider developing your own book-keeping skills so you can take on some of the tasks your accountant does	To get a place on a Bookkeeping workshop, visit www.businesslink.gov.uk/training
	Use accounting software to do the donkey-work for you	Read our guide to Accounting Software at www.businesslink.gov.uk/accountingsoftware
The interest rate on my bank loan is crippling the business	Shop around and find out if you can get a better deal from another bank	Compare rates at www.moneyfactsonline.co.uk/mfbaf or read our guide to Transferring Business Accounts at www.businesslink.gov.uk/switchbanks
	Talk to your bank manager and try and negotiate a better deal – a longer repayment period, for example	Read our guide to negotiating improved terms with your existing bank at www.businesslink.gov.uk/banknegotiations
I've been refused a bank loan. What do I do now?	Find out why so that you can revisit and improve your business plan	For more on what banks look for in a small business go to p14-17
	For a lack of security investigate the Small Firms Loan Guarantee (SFLG)	For more details on how the SFLG works see p16 and visit www.businesslink.gov.uk/sflg
	Businesses in certain areas may be eligible for additional support	To find out about the Community Development Finance Association, visit www.cdfa.org.uk
I've got plenty of orders but I'm finding it difficult to balance the books every month	You could be suffering from overtrading – when a business accepts orders over and above its capability of fulfilment	Read our guide to how to avoid the problems of overtrading at www.businesslink.gov.uk/overtrading
	Try borrowing money against your invoices by using a factoring or invoice discounting service	Read up on how factoring and invoice discounting works on p26-29 and at www.businesslink.gov.uk/factoring
My father has agreed to part fund my venture, so how do I ensure the deal is sound?	Get everything agreed in writing – including the repayment schedule and how problems will be resolved	See more on family funding on p18-19. Also, read our guide to Family Loans at www.businesslink.gov.uk/familybusiness
	Be honest and make it clear that if the venture fails he might lose money. Also outline the possible returns.	Read more about the possible pitfalls involved in family funding at www.businesslink.gov.uk/familybusiness
Where do I find out about grants, and how can I maximise my chances of getting one?	Find out what's available in your local area or industry sector	Search the database of thousands of grants and government allowances at www.businesslink.gov.uk/support
	You'll need to create a full project plan that includes costings and details of the experience of all personnel involved	For more on grants go to p23-24 and read our guide on Finding a Grant Suitable For Your Business at www.businesslink.gov.uk/grants

"My business is operating successfully, and I would like to now take it to the next stage. What different ways are there to do this?"

The next step

When all is running smoothly with your business, you should take stock and plan your next move

IN A NUTSHELL

- A regular review of your business well help you sharpen your focus and aid future planning
- Look at options for growth such as new markets, diversification and joint ventures
- Choose the best way forward and plan how you'll fund this growth

You've put a lot of hard work, time and money into getting your business to where it is today, so it might seem like a good time to let things run as they are for a while. Actually, this is a great time to review your progress and identify how you can get the most out of the market position you've already established. This can help you to identify what the next step for your business ought to be.

Reviewing your progress should be done regularly as it will be particularly useful for:

■ **Proof of progress:** Regular reviews enable you to prove how well your business is performing, to show to yourself and others (like potential investors) that you are getting the most out of your business, and that you are taking advantage of any market opportunities

■ **Planning:** Reviewing your progress will help you keep your business plan up to date – this is especially important if it's not been touched since you started the company. Again this is important if seeking finance, but is also useful as it shows how your business has changed from how it was initially envisioned and highlights where policy changes could be made to suit your actual situation

■ **Focus:** Reviews help ensure the business is moving in the direction you want it to

Useful questions to ask

■ What's my business's direction? Where do I want to go over the next three to five years, and how do I get there?

■ What are my markets, both now and in the future? How can I increase my market share? Which markets should I compete in and what do I need to do to compete there?

■ How do I gain a market advantage? How can the business outperform the competition?

■ What resources do I need to succeed? What skills, assets, finance, relationships, technical competence and facilities do I need to compete?

■ Are there any external factors that might affect my business's ability to compete?

■ How am I measuring success?

Read our guide Review Your Business Processes for tips on answering these questions at www.businesslink.gov.uk/reviewperformance

This is also a good time to revisit your business plan with your new strategy in mind, and make sure you introduce the developments you've identified. If you've pinpointed new market areas or directions you'd like to move your business into, read the Strategy for Growth guide at www.businesslink.gov.uk/growth. For further advice on how to raise funding read the No-Nonsense Guide to Finance for High Growth Companies. ■

"Who produces this guide? Can they offer any more information to help my business, and how can I contact them for further advice?"

Making the most of Business Link

If you have found this guide useful, you may like to learn more about Business Link, and how we can provide further support and guidance

Business Link is a service, managed by the Department of Trade and Industry, providing businesses with easy access to support, advice and information. We're dedicated to helping new and existing businesses innovate, improve, grow and become more competitive by providing quick and easy links to a broad range of private, public and voluntary business support services. This guide is one example of how we provide information to businesses like yours.

We're a national network with a local presence, managed by business people for business people. All of which means we're well placed to understand the diverse needs of businesses and to offer access to relevant and affordable advice. In fact, each year, we help in excess of 500,000 businesses, including both existing ones and start-ups.

How to contact us

Start with the Business Link website at www.businesslink.gov.uk. It brings together the government information and guidance that affects businesses into one accessible place. If you would like to speak to a Business Link adviser face to face, you can visit your local Business Link. Find your nearest one by visiting www.businesslink.gov.uk/directory

Other publications

In addition to this guide to raising finance, we produce a range of booklets and guides on other business-related topics. If starting, for example, the No-Nonsense Guide to Rules and Regulations can provide advice on tax, VAT, employment laws and other relevant areas that may affect your company.

As your business grows, you may also wish to consult our No-Nonsense Guide to Finance for High Growth Companies, which looks at funding options for established businesses that are looking to grow to the next stage.

Find the right publication for your needs at www.businesslink.gov.uk/publications and then you can also use the Business Link website to order a printed copy.

FURTHER GUIDES

- No-Nonsense Guide to Finance for High Growth Companies
- The No-Nonsense Guide to Government Rules and Regulations for Setting Up Your Business
- Employing Staff: A No-Nonsense Summary of Government Rules and Regulations
- Health and Safety: A No-Nonsense Summary of Government Regulations

Want help to run your new business, but unsure where to find finance?

If you need finance for a new business, the **No-Nonsense Guide to Small Business Funding** can point you in the right direction. It offers advice on calculating what you need, what the potential finance sources are, and how best to approach them:

- The value of a strong business plan
- Self-funding your business
- Obtaining loans and overdrafts from the bank
- Accepting finance from family and friends
- Government grants and who may be eligible
- When and how to seek equity investment
- Dealing with cashflow issues

Business Link
This guide is brought to you by **Business Link** on behalf of the Department of Trade and Industry. Contact **Business Link** for a wealth of information and support services to suit your individual needs:
Tel: **0845 600 9006**
www.businesslink.gov.uk

This publication is available in alternative formats

Other No-Nonsense Guides available from Business Link include:
Employment Staff: A No-Nonsense Summary of Government Rules and Regulations
Health and Safety: A No-Nonsense Summary of Government Regulations
The No-Nonsense Guide to Finance for High Growth Companies
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 & Islands contact **Highlands and Islands Enterprise 01463 234171 www.hie.co.uk**
- In Wales contact **Business Eye 08457 96 97 98 www.businesseye.org.uk**
- In Northern Ireland contact **Invest Northern Ireland 028 9023 9090 www.investni.com**

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Every reasonable effort has been made to ensure the information contained in this guide is accurate, but neither the DTI nor Business Link accept any responsibility for any errors or omissions.

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