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GUIDE TO RAISING FINANCE

KEY AREAS TO CONSIDER WHEN RAISING FINANCE

1. Why Businesses Need Finance

There are many different reasons why businesses need finance. Just some of the reasons why you need finance can range from any of the following:

- ***Business start-up*** – before it begins to operate, a business usually needs finance to secure premises, purchase equipment, begin marketing and recruit employees. These costs are incurred before the business receives any revenue.

- ***Running costs*** – once it has been set up, a business must be able to pay for the things it needs to keep operating. These include raw materials, labour costs, utilities, operational costs.

- ***Recruitment*** – recruiting staff always costs a business money. Costs may include advertising the role, conducting interviews, paying for the use of an assessment centre and headhunter fees.

- ***Marketing*** – in order to generate interest in its products and services, a business must advertise and market itself. This will help it to gain sales and increase its market share.

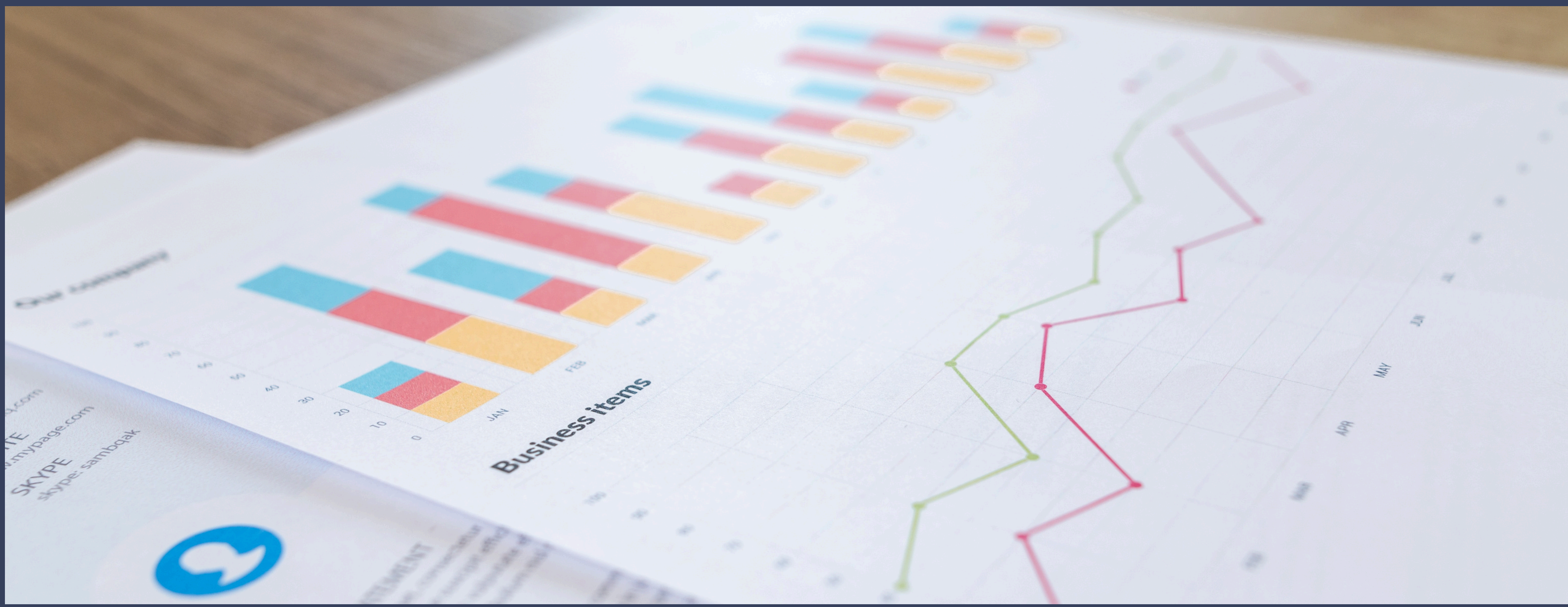
- ***Expansion*** – in order for a business to grow, it requires finance. This needs to be either generated internally or sourced from outside the business.

- ***Mergers & acquisitions*** – often a faster way to scale up is through mergers & acquisitions, which often can require higher levels of finance

Businesses require finance for different lengths of time, depending on why the money is required. For example, a temporary cash flow shortage requires a short-term solution, such as an overdraft. However, the purchase of a machine or a new factory requires finance over a much greater period of time, such as a mortgage.

The finance function monitors and controls the finances of the business so that the business can operate, therefore having a strong CFO/FD/Head of Finance and the finance team below is critical.

2. Things to Consider When Raising Finance



When raising finance there are some critical points that you should give consideration to before proceeding. Just some of these are as follows:

Start with the end in mind – being clear on ultimately where you want to get to is important as that can influence the way you raise finance, the amounts needed and over what time period. It can also have an impact on how you structure a deal from a legal and tax perspective.

What do you need the money for – being clear on how you will deploy the capital once you get it is critical. So often businesses raise finance without having a detailed plan on what they will spend it on.

The returns and results you are expecting to see – it's only worth raising finance if you are able to move the business forward as a result of raising the finance in the first place. Having a clear return on investment for specific projects/activities is important as well as the operational benefits y ou can deliver.

How long do you need it for – as we discussed above depending on the reason for the finance raised will dictate how long you need it for and therefore what costs you are likely to incur. Short term lending, for example, could include a revolving credit facility with your bank, whereas significant investment projects may require a longer time frame and therefore involve more risk for the investor for which they would expect higher rates of interest.

Are you prepared to give away equity in your business – bringing an investor on board can often mean an exchange of funding in return for equity in your business. It's important to have an idea of the value of your business today and in the future which can then influence the % equity given.

Are there other qualities you are looking for in an investor – it's not always just about the money. If you bring an investor into your business in exchange for equity, it's important that you have a clear idea of the other qualities you are looking for in an investor, eg skills, experience, network, personality traits, communication style etc.

3. Ways of Raising Finance Internally

Finance is used to address short, medium or long-term needs and can be sourced internally from a business' own capital, profit or assets, or externally from banks or other investors. However, a business must consider the advantages and disadvantages of each method before deciding which is the best option.

The methods available to a specific business depend on the business type.
There are several ways for a business to raise money internally.

a. Owner's capital & Bootstrapping

Owner's capital is money that has been saved up by an entrepreneur. It is also often known as 'bootstrapping' and is commonly used during start-up or expansion, or to replace capital equipment. It is most suited to new or established businesses and is available to sole traders and partnerships. This source of finance does not usually cost a business any money, as there often an owner may decide to lend to the business with no interest charges. However, if the owner or owners of the business do not have enough savings, they will need to use an additional source of finance.

Other potential sources for you to 'bootstrap' your business could include:

- ***Friends and family*** – If you can, ask those close to you. They know you, you know them and you may find they would be delighted to help finance your new venture.

- ***Personal assets*** – Cash resources, credit cards – what have you got immediately to hand that would mean less reliance on outsiders?

- ***Co-founders*** – If you're going into business with someone, remember it is a joint venture. If you've exhausted your resources, have a frank and honest conversation with your partner. What can they bring to the table?

b. Retained profit

When a business makes a profit, it can leave some or all of this money in the business and reinvest it in order to expand. Therefore, this source of finance can only be used by established businesses. This source of finance does not incur interest charges or require the payment of dividends, which can make it a desirable source of finance. However, it is only available to businesses that have made a profit.

c. Sale of assets

A business can sell a fixed asset in order to generate finance. Because the business must own the asset, this source of finance can only be used by established businesses. It is commonly used to fund expansion or replace capital equipment.

This is a good source of finance to use if the asset is no longer of use to the business. A disadvantage of this source of finance is that it can take time to sell the asset or a buyer may not be found.

4. Ways of Raising Finance Externally

a. Overdrafts

Overdrafts are one of the most common forms of finance and are generally used to cover short- term cash flow problems. However, they should be used carefully and only in emergencies as they can become expensive due to the high interest rates charged by banks. Overdrafts are used by all types of business, both new and established.

Common features of overdrafts include:

- **Variable interest rates** - the cost of borrowing money changes when the interest rate changes

- **Flexibility** - a business uses its overdraft only when it needs to, the business only pays interest when the overdraft is in use
- **The bank can demand full payment** - banks can demand full repayment of an overdraft within 24 hours

b. Trade Credit

Trade credit must be agreed with a supplier via a credit agreement. This source of finance allows a business to obtain raw materials and stock but pay for them at a later date. This is therefore an example of a short-term source of finance. The payment is usually made once the business has had an opportunity to convert the raw materials and stock into products, sell them to its own customers and receive payment. This source of finance is suitable for all businesses.

Common terms and conditions found in a credit agreement include:

- **Credit limit** - the maximum amount of credit available to the business
- **Credit period** - the length of time the business has to pay what is owed, usually 30, 60 or 90 days
- **Frequency of payment** - how often payment is required, usually monthly
- **Method of payment** - the way in which the business will make payment, eg bank transfer, cheque or card payment
- **Retrospective discount** - a discount given when the business has purchased a certain amount of stock or raw materials

Trade credit often allows a business to receive payment from its customers before it pays its suppliers, which improves cash flow. Trade credit is also often free from interest. However, businesses must pay their suppliers even if they aren't able to sell products to customers. If a business fails to pay within the agreed credit period then the supplier typically charges interest on the money that is due.

c. Asset Finance

If you're familiar with hire purchase and leasing, you're on your way to understanding asset finance. Put simply, it is a way of financing your venture by obtaining the equipment you need to grow, usually by spreading the cost of the kit over an agreed period of time. Also, this type of finance can be used for a range of 'capital items' or fixed assets including plant, equipment, vehicles, IT equipment and even far more specialist items like marine vessels and aircraft.

d. Invoice Finance

This is suitable for B2B businesses where they can borrow against the value of work completed and invoiced. The two main products are factoring and invoice discounting although there are other hybrid services. It enables businesses to draw funds against sales invoices, before receiving of remittance from the customer. Done correctly, it'll improve your cash flow and working capital. As a result, this type of finance is ideal for expanding businesses including new-starts.

e. Loan

A loan is money lent to an individual or business that is paid off with interest over an agreed period of time. Usually the rate of interest is fixed. Having to repay a loan with interest is a disadvantage of taking out a loan, but it does mean that a business knows in advance what the cost of borrowing will be and what monthly repayments will be required. This is an advantage of taking out a loan as it allows a business to plan ahead.

To get a bank loan, a business must apply to a bank. The bank then carries out credit checks to see the financial history and reliability of the business. The bank may require the business to secure its assets against the loan. This means that if the business is unable to repay the loan, the bank can demand the sale of the assets to raise money to pay back the loan. If a business does not have enough assets, a bank may require a guarantor to repay the loan if the business does not make its repayments on time.

It's important to think about the implications if things go wrong. Nobody goes into business expecting to fail but, up to 50% of new-starts don't last 5 years. To reduce risk for the bank it will usually demand some form of security for the loan (a property, for example), so you should bear this in mind and consider the implications for you personally in the event the business fails.

f. Share Issue

Share issue is money raised by shareholders through the sale of ordinary shares. Buying shares gives the buyer part ownership of the business and therefore certain rights, such as the right to vote on changes to the business. This can slow down decision-making processes.

Advantages of share issue include:

- **Share issue is a source of permanent capital** – shareholders cannot have a refund on their shares. Instead, if they want to sell their shares, they must find someone else who wants to buy them.

- **There are no dividends to be paid if the business has a poor year** – shareholders are not promised dividends every year, as dividends are only paid if the business has made sufficient money to pay all of its costs.

Disadvantages of share issue include:

- **It dilutes control for the founders –** the more shares that are issued, the more shareholders there are who own part of the business. This results in the founders having less control. In order to have a majority stake in the business, the founders must hold more than 50% of the shares.

- **The business is vulnerable to takeove**r – as a business grows and sells more shares, it becomes vulnerable to the threat of a takeover. This is because the shares are sold publicly and if an individual or group buys enough shares, they can persuade other shareholders to vote for a new management team.

g. Crowdfunding

Crowdfunding involves a large number of people investing small amounts of money in a business, usually online. Commonly used crowd-funding websites include Crowdfunder, GoFundMe and Kickstarter.

Advantages of crowd funding include:

- **It acts as a form of market research** - If people don't invest, it means the business idea is not attractive or distinctive enough, which indicates that the business is likely to fail.
- **It provides opportunities for start-ups** – This allows individuals to start up a business even if they don't have access to other sources of funding.

Disadvantages of share issue include:

- **The business must be interesting** - Crowdfunding is most successful when the business idea is appealing, interesting and innovative.
- **It can be difficult to reach the funding target** - Statistics from crowd-funding websites indicate that under 33% of businesses achieve their funding target.

h. New Partner

Taking on a new partner can bring new finance to a business. It is usually used for buying or replacing capital equipment or to help business growth.

Advantages of taking on a new partner include:

- It can bring new skills and expertise to the business
- It doesn't incur any new costs to raise the finance

Disadvantages of share issue include:

- The new partner will share the profit, from the business
- The new partner will have a say in how the business is run, depending on the level of equity they hold

5. Other Key Factors to Consider

Raising finance can be a daunting task, so it's important that business owners are fully informed of their options and seek guidance from experts who can advise and help structure the various options, not only from a financial perspective, but also to consider any legal and tax implications.

Various other factors need to also be kept in mind regarding sources of finance:

- Sole traders and partnerships cannot sell shares to raise finance
- Limited companies are unable to take on extra partners to raise more finance
- Banks are unlikely to offer overdrafts or loans to businesses with poor financial track records
- Businesses that want to undertake risky activities and ideas that appear to have a limited future may also find it difficult to raise finance

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