

ROUND AND ROUND THE FINANCING MAZE

FUNDING YOUR BUSINESS CAN BE DAUNTING AT THE BEST OF TIMES, BUT IN A RECESSION?
DEBBIE CLARKE SPEAKS SOME SOOTHING WORDS



Finding a reliable source of funding can be a minefield during a recession. The biggest problem companies are experiencing is that it's taking a very long time to raise money (in the form of debt, equity or grants). That said, there is plenty of funding available – you just need to know where to look.

In the first instance, understanding your company's working capital requirements and any patterns in trading is essential. Good cashflow forecasts will enable you to identify how much funding you need, and also what level of finance servicing you can afford.

If cashflow is staggered a bank loan may not work, because you may have difficulties repaying capital and in meeting covenants. So what are your finance options? They can be split into three areas: grants, debt and equity finance.

GRANTS

Grants provide support to start-up businesses or businesses starting new projects. They are typically from either local or national government. The Local Government Finance initiative works specifically with local communities to develop new businesses (see www.communities.gov.uk/localgovernment/

localgovernmentfinance/labgi/). There are also a number of innovation, research and development grants for businesses looking to develop or utilise new technologies. Information on these and other types of grants are available through Business Link, see www.businesslink.co.uk. Finally, there are grants for companies looking to make investment through the purchase of assets (see www.berr.gov.uk/whatwedo/regional/investment/page29183.html).

While grants can provide a good initial source of funding because they do not always need to be repaid, they are time-consuming to apply for and the guidance is not always clear. Local accountants are in a good position to help their clients with these applications. Business Link is also helpful.

DEBT

So if grants are not for you, where else should you look? Mortgaging a business property could be a start. While mortgages are more difficult to secure than they were a couple of years ago, banks are still open to lending against property, but at lower levels than previously.

The common perception is that raising debt finance

is extremely difficult in this current market; however, the fact is that the banks are lending. This is because government intervention has put pressure on the banks to continue lending, and the expectation is for this to continue over the coming year. Government initiatives such as the Enterprise Finance Guarantee Scheme is a good example (see www.businesslink.gov.uk/bdotg/action/gsdDetail?type=GSD&itemId=1081834978).

Talking to your bank about invoice discounting – which involves advancing money to you against a percentage of your debtor ledger (typically up to 80%) – can help smooth monthly cashflows. Banks have been keen to switch customers who are on unsecured overdrafts into invoice discounting facilities. For some customers this can be a good thing, as an invoice discounting facility can grow as you grow, unlike an overdraft.

Invoice discounting is provided by all the high-street banks and a number of asset finance specialists, so be sure to shop around for the best overall rates and service charges. Many of these funders can also provide stock finance, but this is usually only provided as part of an invoice discounting facility. Many importers and distributors have struggled in recent times with sourcing trade finance; however, trade finance is improving and some banks are being creative in how a facility works. Historically they would look solely at providing letters of credit for example, but they are now looking at more revolving facilities that allow the customer greater flexibility.

Financing plant and machinery is one area of asset finance that is still very difficult to fund. Many of the funders have withdrawn from this market, and it is hard to see when it will return. This is in part due to concerns about resale values of equipment in a recession.

Care must be taken when raising debt funding of any description. A robust financial forecast model is important for a company to understand what gearing works for their business as well as how much debt they can afford to service. Where low gearing is necessary but there is still a funding gap, then equity finance is the next step.

EQUITY FUNDING

Equity funding can take many forms: investments from family and friends, government-backed equity funds such as Capital for Enterprise (CfE), angel investment and venture capital and private equity. With all equity investment it is imperative that you have a well-structured business plan and that the investor understands where their money is being invested. A descriptive shareholders' agreement will help to ensure goal congruence between all parties.

Approaching family and friends is often seen as the first port of call for early-stage businesses because of the difficulty many experience in raising initial funding.

One important point that companies looking to raise money often forget is that you should do due diligence on the company providing the funding (debt or equity)

This is the riskiest stage for any type of investment, and family and friends need to understand that their investment is at risk. When a company has been operating for a while, other forms of equity finance are open to them. CfE is a new government-backed initiative managed by Octopus Investment Limited and Maven Capital Partners. These investment houses have a £75m fund with which to make investments in the range from £0.25m to £2m. As with EFG, there are investment criteria that need to be met, and it is not suitable for everyone.

Angel investors can bring both money and expertise to the business, which can be invaluable. Sourcing an angel can be difficult however, so a good starting point is one of the many angel networks, which manage a number of individuals and also help companies with the pitching of their business. The most structured form of equity finance however is venture capital and private equity. Money is available for investing in many funds, but the key is that a business must be robust and have a very clear business plan before it seeks such funding. Equity investors of all types are looking for high returns on their investment because of the risk they take in the early stages.

One important point that companies looking to raise money often forget is that you should do due diligence on the company providing the funding (debt or equity) as much as they do due diligence on you. For example, when approaching equity investors, ask to see details of returns they have made for other investee companies. You want ideally to have an investor on board who can help you make the same returns.

Ultimately the choices for financing are as wide now as they have ever been, but the difficulty comes in the time it takes to secure such funding. Seeking good advice and preparing yourself in advance is imperative. A company is more likely to be successful at raising bank debt or equity funding if it can present a clear, well thought-through business plan and can explain exactly why they need the funding they are asking for.

Finally, try to pre-empt cashflow shortfalls – it is hard to raise money when your back is against the wall and impossible if you have put your head in the sand and ignored the problems. Communication, with your accountants, advisers and bank manager, is key – it will give you more time to plan and structure your funding requirements.

IN A NUTSHELL...

■ Grants

These provide support to start-up businesses or businesses starting new projects. They are typically from either local or national government.

■ Debt

Mortgaging a business property could be a start. Also consider invoice discounting.

■ Equity funding

This can take many forms, from investments from family and friends, government-backed equity funds such as CfE, angel investment and venture capital and private equity.

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