solutions for business cashflow

20 WAYS to finance a business

a comprehensive guide

advocatefinance

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INTRODUCTION

Most businesses that need finance only look as far as the High Street banks. With the credit crunch making it more difficult than ever to find funding, sole reliance on a bank limits the finance solutions available and could affect the survival of a business.

There is also a worrying lack of information about the types of finance available to businesses. Many guides and websites only cover five or six options.

Advocate Finance therefore decided to develop an impartial and comprehensive guide to business finance solutions, written by an independent expert who is actively involved in arranging business finance. The 20 approaches outlined here represent solutions provided by over 100 lenders.

You will already know some of the methods described in this guide. However there are some 'gems' that you won't know about, or have never considered.

SCOPE

The guide deals with business finance and therefore does not cover start-up equity investments (such as Business Angle or Venture Capital). It focuses specifically on finance options available to small and medium enterprises (SMEs), with a typical turnover ranging from £250,000 to £10 million. It therefore excludes some of the complex financing schemes that are available to large organisations.

This document does not constitute financial advice under the Financial Services & Markets Act 2000. If you need further information and advice, please contact us for a free assessment.

KEY PRINCIPLES

1. An effective business finance solution might involve several different methods and lenders. For years, we have been encouraging businesses not to put all of their 'eggs in one basket'. You can protect your business's future by avoiding too much reliance on a single source and lender.

2. We have access to over 100 lenders. If you have previously been refused one of the finance options mentioned in this guide, another lender may still consider your request and might approve the finance.

CONTENTS

METHOD	BUSINESS FINANCE SOLUTION	PAGE
1	Bridging Finance	4
2	Commercial Mortgage	4
3	Release Equity	5
4	Hire Purchase and Finance Lease	5
5	Operating Lease / Contract Hire	6
6	Sale and Leaseback / Asset Re-finance	7
7	Factoring	7
8	Invoice Discounting	8
9	Export Finance	8
10	Trade Credit / Import Finance	9
11	Payroll Finance	10
12	Overdrafts	10
13	Stock Finance	11
14	Business Loans	11
15	Director / Partner Loans	12
16	Sale and Leaseback of Property	12
17	Enterprise Finance Guarantee Scheme	12
18	Cash Flow Loans / Structured Finance	13
19	Merchant Finance	13
20	Turnaround Finance	14

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1) BRIDGING FINANCE

This is short term finance (available from 1 to 12 months), associated with the purchase of property. One use is to provide finance for auction purchases where funds are required within 28 days for completion.

However, it has many other uses. In fact, some lenders will provide it for any legal purpose. It has been used to purchase small businesses whilst long term finance is arranged. It has also enabled firms to pay off creditors who have petitioned for bankruptcy (where the customers were asset-rich but cash-poor and were waiting for property to be sold).

✓ PROS
- ✓ Funds available within 2-5 days
- ✓ Proof of income and affordability not required
- ✓ Can be used for any legal purpose

✗ CONS
- ✗ Interest rates are high, so it should only be used for a short period

2) COMMERCIAL MORTGAGE

This is used to buy commercial property (e.g. an industrial unit) or a trading business connected with a property (e.g. a restaurant or hotel). A property investor might use a commercial mortgage to buy a property which is currently being leased by a business tenant.

Some 30 lenders offer commercial mortgages, with terms ranging from six months to 30 years. The financial terms offered, conditions of approval and security required vary considerably and independent advice should be sought to ensure that you get the best deal.

If you're buying a trading business, some lenders will help to finance the goodwill and fixtures and fittings whilst others will only lend against the property itself. The different deposit requirements will

therefore be huge and this can make a significant difference to the viability of a deal.

✓ PROS
- ✓ Long term finance can make payments affordable
- ✓ Interest rates can be very competitive compared with other types of borrowing

✗ CONS
- ✗ The amount of legal work can slow down the transaction
- ✗ Can involve a high deposit if the wrong lender is chosen

3) RELEASE EQUITY

Commercial mortgages and other types of property finance can be used to re-finance property and release equity that was previously tied up in buildings.

Many lenders will consider these deals. The benefit is that the financing can be spread over long terms (up to 30 years), thereby reducing the monthly repayments. Unlike an overdraft, the loan would not be repayable upon demand. This can give a business confidence that the finance isn't going to be suddenly withdrawn.

Strictly speaking, any type of property can be considered if there is enough equity. At the request of clients, we have even refinanced buy-to-let properties and these funds were then given to the trading business as a loan from the director.

✓ PROS
- ✓ The loan is not repayable on demand

✗ CONS
- ✗ May take time to implement, due to taking a legal charge over the property

4) HIRE PURCHASE AND FINANCE LEASE

Both of these methods can be used to buy and then finance any type of assets - including cars, vans, trucks, computers etc. As long

as the asset can be identified and is moveable, it can be financed. Most people don't realise that in certain cases, 'soft' assets can also be financed. These range from computer software that is part of a larger computer equipment purchase or the fitting out of a bar, restaurant or shop.
One of the main benefits of asset finance is that it's self-securing. This means that the asset being financed should provide enough security, so the finance can be provided without director guarantees and without affecting overdrafts, loans or any other finance deals with other lenders.

Some businesses use their overdraft facility to acquire assets. This is NOT recommended. If an additional asset finance credit facility can be used to acquire the assets, this should be the preferred route. This leaves the overdraft facility available to the business, giving it the flexibility it requires to handle the day-to-day cash flow.

✓ PROS	✓ Self securing
	✓ Can be very fast to obtain and is available for most assets
✗ CONS	✗ Beware of the end of lease terms if you ultimately want to acquire the assets

5) OPERATING LEASE / CONTRACT HIRE

These two schemes are associated with assets that have a residual value after the end of the finance term. Contract hire (which is legally a form of operating lease) is associated with vehicles. Instead of the customer repaying the full cost of the vehicle over the term, they only pay the depreciation element.

An operating lease is the same but is used for plant and equipment. A residual value is set and the depreciation between the purchase price and the residual is repaid over the term of the finance. The key benefit of this method is that involves much lower repayments.

✓ PROS ✓ Low repayments
✓ Tax effective for businesses that can't claim capital allowances

✗ CONS ✗ On contract hire, beware of the conditions for excess mileage and wear and tear charges

6) SALE AND LEASEBACK / ASSET RE-FINANCE

During the credit crunch, a number of businesses have been using this method to raise finance. In basic terms, a business sells an encumbered asset to the finance company and funds are paid for its sale. The finance company immediately enters into a hire purchase or lease agreement with the business to allow them to use the asset again. The asset is never physically moved elsewhere, but the net effect is that this releases funds that are tied up in assets.

The assets suitable for this type of finance are those that will have some value at the end of the financing period. These include cars, vans, trucks, plant and equipment.

✓ PROS ✓ Releases equity that is tied up in assets/machines but that can't be accessed by any other financing method

✗ CONS ✗ You must choose the most competitive provider
✗ Seek good advice from an expert in this field

7) FACTORING

Some business people dislike factoring because it used to have an image of being of the last resort for lending. However, today it is operated by banks and very reputable independent lenders and we continue to see businesses who use it and go on to be very successful.

In its simplest terms, factoring is available to businesses that have to offer trade credit to their customers. This credit drains the

businesses of cash flow and ties up cash in money owed (by 'debtors'). Factoring allows the business to sell debts that are due in 30 to 90 days to a factoring company in exchange for instant cash.

This area of business finance is one of the most complex in terms of the services offered and the charges levied. Businesses will typically be asked to sign up for a 12 to 24 month contract, so companies should seek the best advice possible to ensure that they end up with a facility that meets their needs.

✓ PROS ✓ Facility grows with the business
✓ Available to start-ups
✗ CONS ✗ If you choose the wrong lender, you can end up with an expensive and inflexible option

8) INVOICE DISCOUNTING

This approach is similar to factoring. The main differences are that the end customer never knows that the business is using an invoice discounting facility, whereas factoring is disclosed on the customer's invoice.

Discounting offers fewer services than factoring and is purely a financing method. To be eligible, businesses need a large turnover (typically from £1 million to over £100 million) and robust financial management systems.

✓ PROS ✓ Releases up to 90% of debtors
✓ Lower costs than factoring
✗ CONS ✗ If you choose the wrong lender, you can end up with an expensive and inflexible option

9) EXPORT FINANCE

This is a further evolution of factoring and invoice discounting. The reality of dealing with exporting goods is that customers take longer

to pay for goods, due to the extended delivery time. This extended waiting period puts increased pressure on cash flow.

Export finance can release funds tied up in debtors based overseas. Additional services can include bad debt cover and multi-lingual credit control.

✓ PROS ✓ Credit control for overseas business and funding for Export sales

✗ CONS ✗ Some lenders limit the exposure to export finance, which can limit sales

✗ The choice of lender is crucial

10) TRADE CREDIT / IMPORT FINANCE

Credit terms are normally required for business-to-business trading. Most businesses offer each other terms ranging from 30 to 60 days. However, problems arise if you're a start-up or relatively new business. You may need credit terms much larger than the business will give you. Or you may need to import goods where an importer won't usually offer credit terms - so the payment is made in advance or when the goods are shipped.

With trade credit or import finance, a lender effectively underwrites a credit facility, giving peace of mind to the supplying business. This could be a UK company supplying another UK company or an overseas business supplying goods to a UK business. In both cases, the lender states that the supplying business will get paid as long as the supply agreement has been met.

Banks offer these facilities - but normally require a property as security. However, more specialist lenders will look at the goods and the end customer as security.

✓ PROS ✓Additional credit facility to allow the business to succeed

✗ CONS ✗ Very strict criteria govern the goods that can be financed

11) PAYROLL FINANCE

This is a unique facility offered by a specialist independent lender. The finance provides a 60 day credit facility for businesses, which can be used for funding the payroll.
Businesses may normally pay wages and PAYE from their overdraft. A facility that pays these costs for 60 days leaves funds in the bank account for other uses.
The facility is totally unsecured. No legal charges or guarantees are required by the business owners. This is a revolving facility, so after 60 days the first month's payroll finance is repaid. The business can then fund the third month's payroll and can potentially continue in this way forever.

✓ PROS ✓ Employees are never made aware of the facility
✓ Totally unsecured and doesn't affect existing credit facilities

✗ CONS ✗ Only available to businesses with a monthly wage bill of over £20,000

12) OVERDRAFTS

This is possibly the most common form of business finance in the UK – and is also probably the reason why most business have suffered during the credit crunch. They have tended to place too much of their borrowing on overdrafts, only for these to be reduced and the interest rates substantially increased.

Overdrafts should be used for what they were designed for - to cater for short term, not long term funding.

✓ PROS ✓ When you don't need them you don't pay any interest charges on them.

✗ CONS ✗ Repayable upon demand
✗ Can limit sales growth if too much reliance is placed on them

13) STOCK FINANCE

This provides funds secured on stock for which businesses have paid. The amount that can be raised varies from 25% to 50% of its value. The type of stock is very important and needs to be in a form that can be sold on to repay the finance in the event of an insolvency.

Therefore, most raw materials would be excluded. This solution would normally form part of a wider facility from a lender, such as factoring or invoice finance.

✓ PROS ✓ Another credit facility that can be accessed if necessary

✗ CONS ✗ Only certain types of stock are eligible

14) BUSINESS LOANS

The main lenders are the High Street banks. However, there are a few specialist lenders that will approve good business propositions even if a bank has refused the loan request. Terms can vary from a few months to many years. Typically, the maximum amount before security is required is £25,000, after which a bank will usually require a charge over equity in a property.

It's worth understanding how most banks calculate equity. If a property is valued at £250,000, the bank would reduce this by 30% to produce a forced sale valuation. In this case, the revised valuation would be £187,500. If the property had a mortgage of £150,000, the equity as security for the bank would be £37,500 (and not the £100,000 that the owner would view as their equity).

✓ PROS ✓ Can generally be unsecured up to £25,000
✓ Available from most banks

✗ CONS ✗ Banks sometimes push these when asset finance would be a cheaper, quicker and easier option for obtaining credit decisions

15) DIRECTOR / PARTNER LOANS

This is a two-stage process in which the director or partner injects capital into the business as a loan. For example, a director might raise money on a buy-to-let property that he owns personally and these funds are then transferred to the Limited company as a loan.

✓ PROS ✓ Finance can be raised from assets not owned by the business

✗ CONS ✗ Not all lenders will approve the use of personal funds for business purposes

16) SALE AND LEASEBACK OF PROPERTY

This can be useful when a business wants to continue to trade from premises that it owns but wants to raise finance against these. The business can sell the property to a third party investor, who would then lease it back to them.
The business gets the equivalent of a 100% finance of the property value and continues to trade from the property.

✓ PROS ✓ Can also be useful in management buy-outs where the new management team can't raise enough funds for the property

✗ CONS ✗ The business loses out from future capital increases in the property

17) ENTERPRISE FINANCE GUARANTEE SCHEME (EFGS)

This new government initiative replaces the Small Loan Guarantee Scheme (SLGS).

The EFGS is currently offered by 23 lenders in the UK. It provides a government guarantee for 75% of the loan. It is used by lenders when the credit-making decision has approved the loan, but there is a lack of security for it. The EFGS steps in and provides the security that the lender requires.

Terms range from three months to ten years. Businesses with a turnover of up to £25 million and loans of up to £1 million are eligible for the scheme.

✓ PROS ✓ Provides finance where no security is available
✗ CONS ✗ There is a charge for the guarantee, increasing the costs

18) CASH FLOW LOANS / STRUCTURED FINANCE

These finance facilities are technically unsecured and are suitable for management buy-outs and buy-ins. The proposal needs to be extremely strong in terms of the management of the business and its ability to generate cash and repay the loan in a relatively short period of time. The loans are normally approved as part of a larger facility provided to the business.

✓ PROS ✓ Can also be useful in management buy-outs where the new management team can't raise enough funds
✗ CONS ✗ Only suitable for the most credit-worthy businesses

19) MERCHANT FINANCE

This is a form of unsecured finance for businesses, where a large proportion of revenue comes from customers paying on debit / credit cards. The lender provides the business will an unsecured loan which is repaid to the lender out of future credit / debit card receipts.

A facility of up to 20% of the typical annual credit / debit card receipts is provided. Once the advance is repaid, it then acts as a revolving facility, as it can be used again in the future.

✓ PROS ✓ Totally unsecured
✓ Available to businesses that can't get finance from a bank

✗ CONS ✗ The business has to change the card processor to the lender's agent so that they can collect the repayments

20) TURNAROUND FINANCE

A sound business can suddenly get into trouble for many reasons - such as a bad debt, or because a key person falls ill or dies etc. In the short term, the business can struggle and may need a fresh injection of capital.

Turnaround finance introduces fresh equity in return for a stake in the business. This new equity can be used as a strong argument for a lender to provide finance so that the business can be turned around and become successful again. The equity comes from successful investors who can also provide management experience if required.

✓ PROS ✓ A real lifeline when a solid business faces difficult times

✗ CONS ✗ An equity stake in the business would need to be given away

THE AUTHOR

David Tonks is Principal Advisor at Advocate Finance, a company that specialises in providing impartial and independent advice on the arrangement of business and property finance solutions. With over 20 years' experience in banking and business finance, together with access to over 100 lenders, Advocate Finance is committed to providing clients with the finance that meets their specific needs.

The key benefits of independent and impartial advice include:

1. Access to better financing terms
2. Finding lenders that say "Yes", even when you have been refused by other lenders
3. Business plans that are successful with lenders
4. Obtaining finance without the onerous conditions and security required by some lenders
5. Solutions for protecting and generating cash flow
6. Access to finance products not available through High Street banks
7. Fast decisions and a quick release of funds
8. If the required finance is too large for just one lender, we can split it and source it from two or more lenders

Our lenders include:

Building Societies	Private Banks	Independent lenders
High Street Banks	European Banks	Bank subsidiaries
Regional Banks	US lenders	

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