Raising Finance

The way you finance your business is one of the key factors that will impact on how profitable you are. There are three main ways to raise capital:

- Shareholders' equity – your's or other investors' money.
- Reserves – profits put back into the business.
- Borrowed funds.

This fact sheet will cover the ins and outs of borrowing, including types of finance available and issues relating to applying for loans.

Once you have decided to raise capital by borrowing money, you need to consider what source and type of finance will suit your needs.

It is important that you match the method of funding and term of the loan to the purpose for which the finance is being used.

Be aware that your financing decisions can seriously impact on business cash flow and taxation obligations.

Which lending institution?

There is a range of lending avenues you can use, including: banks, building societies and credit unions, finance companies and finance brokers.

Each has its own particular pluses and minuses, covering issues such as:

- borrowing criteria;
- repayment options;
- interest rates;
- incentives;
- location and service.

How much capital?

You need to make a realistic assessment of your financial needs, including start-up costs and how long it will take before your business can become self-supporting. This will form part of your business plan and is essential for your loan application. Take a look at the fact sheets ***Are You Ready to Start a Business?*** and ***Business Planning***.

Your assessment needs to demonstrate that you will be able to repay the loan, taking into account possible risks such as lower than forecast sales or increases in interest rates.

Types of finance

Short term finance

This form of finance is commonly called "working capital", required to fund the day-to-day running of the business. Working capital should not be used for long-term projects as it is generally more expensive (in terms of interest rate) than money paid back over a longer period. Some examples are:

Bank overdraft: An overdraft can be used to cover cash flow shortfalls from day to day. The interest will be calculated on your daily outstanding balance and is usually charged on a quarterly basis. Depending on your financier, an overdraft facility may also incur other fees.

Commercial bill: An arrangement where money is made available for a short period, at the end of which you must repay the borrowed amount. Commercial Bills can be drawn for terms ranging from 30 days up to a maximum of 180 days. They are commonly used to meet the seasonal funding needs of a business.

Debtor finance: An arrangement where a finance company provides a cash advance to the business against sales made (invoices). The "loan" is repaid when the debtor pays the invoice.

Trade credit: A short-term source of finance obtained by buying goods and services that do not require immediate payment. If managed carefully, this can reduce the capital investment required to operate the business.

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You're more likely to succeed in your loan application if you provide a well researched and presented business plan which includes:

- *your business goals and longer term objectives;*
- *market research that supports your financial projections and proposed borrowings;*
- *information systems you will put in place to allow you to monitor the business and respond to changes affecting your projections.*

Medium term finance

Usually required for a 3-10 year period, this is principally used to finance equipment, business expansion and development of new products. Examples are:

Term loans: A loan paid back over an agreed period (term) where principal and interest rate are paid off in monthly repayments. It is commonly used by businesses wanting to structure their loan repayments to correspond with the income produced from equipment purchased or sales of new products. It may be for a five or 10 year period.

Personal loans: Where it is not possible to arrange a loan in your business name you could consider arranging a personal loan. This can then be contributed as equity or as a loan to the business.

Leasing: The financier purchases the equipment you require and then leases it to you in return for regular rental payments (usually monthly) for the duration of the lease period. At the completion of the lease term you are offered the option to purchase the equipment at an agreed residual value.

Long term loan

This type of finance is used to fund the purchase of assets such as the business itself, land, buildings, plant or machinery which will directly or indirectly contribute to profit over a period of years. Term loans would be the most common way to structure long-term borrowings.

Applying for a loan

Loan applications require a lot of detail, including:

The business: A short description of the business - its history, past achievements, products and services, number of staff involved, location and a description of the premises, machinery, equipment, vehicles and other key assets. For start-ups, describe the products and services you intend to provide, projected demand for your products/services and your marketing plan.

Your history: Details of your own and other stakeholders' educational qualifications, business experience and past achievements.

Amount and purpose of loan: The amount and purpose of the loan should be covered in detail, including how the amount was arrived at.

Repayment: Clearly establish how the loan repayments will be made.

Financial statements: Sales and profit projections over the term of the loan and, if an existing business, current balance sheet and the last three years' annual accounts. Include a monthly cash flow budget for the 12 months ahead with the loan repayments included.

Security

Lenders usually seek some form of security from you, such as:
- assets such as real estate or shares in public companies.
- surrender value of an insurance policy.
- personal guarantee.

More Information

SOURCES OF INFORMATION

Visit the NSW Department of State and Regional Development small business website for more information on business & financial planning, and more general business information at: www.smallbiz.nsw.gov.au.

WHO SHOULD I TALK TO?

Your local Business Advisory Service can offer you one on one advice on your financing options and how to access accountants in your local area. It also offers low cost business and financial planning workshops.
Call 1300 650 058