SMALL BUSINESS STARTUP

Funding Your Business

Your business idea may be solid, but without adequate funding your chances of success are slim. Starting a viable business takes judicious financial planning.

There are several different ways to fund your small business, each with their own advantages and disadvantages. The appropriate funding option for your business will depend on a number of factors, including business size, legal structure, projected growth and financial stability. The following is an overview of six common forms of financing for your new or growing business.

1. Investment Finance

Also known as equity finance, investment finance involves selling part of your business to an investor as shares. The investor then shares part of the business' profits or losses.

Advantages

- Investors can jump-start the business by using their expertise and providing new opportunities for growth.
- Injecting more money into the business increases financial stability.
- You will not have to pay interest or repay a loan.
- You share risks with your investors.

Assess Your Needs

There are six types of financing you can consider for funding your small business:

1. Investment finance
2. Loans
3. Grants
4. Overdrafts
5. Invoice financing
6. Leasing and asset finance

Be sure to examine your business' financial needs in order to choose the most appropriate and cost-effective funding options.

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Disadvantages

- Selling shares to investors can be complicated, expensive and time-consuming.
- You will own a smaller share of your business.
- You may have to consult investors before making management decisions.
- Only limited companies can sell shares, so sole traders and partnerships cannot resort to investment finance.

2. Loans

Loans are a type of credit that the borrower repays over a pre-determined length of time. In addition to repaying the amount you borrowed, you will probably have to pay interest. The amount of interest depends on the following:

- How long you need the loan
- How much you borrowed
- Whether the loan is secured (that is, you provided something you own, such as your house, as collateral)

Your interest rate will either be fixed, which means it won't change during the course of the loan, or it will be variable, which means it will change with bank costs. Because of this, it is more prudent to take out a loan when your costs are stable—otherwise you might not be able to pay back the borrowed money if your expenses grow but your income doesn't. You can apply for loans through private financial providers, such as banks, or through public funding, such as government schemes.

Advantages

- Loans are not repayable on demand, so you are guaranteed the money for the whole term (usually three to 10 years).
- You will not have to give your lender a percentage of your profits or shares.
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Disadvantages

- Loans are not flexible—the terms are set early and do not change.
- You could struggle to make payments if your business suffers a setback.
- If your loan is secured, missing payments could mean losing your collateral.

3. Grants

You can apply for grants through private institutions like charities or public institutions like the government or European Union; however, there is usually a lot of competition. Grants are usually awarded for a specific project or purpose.

Advantages

- You do not have to pay grant money back or pay any interest.
- You will not lose any control over your business.

Disadvantages

- You must find a grant that matches your specific project, which can be difficult.
- There is often a lot of competition for grants.
- You may have to match your grant funds.
- The application process is time-consuming.

4. Overdrafts

An overdraft is a credit facility that you agree to with your bank. It temporarily allows you to spend more money than you have to cover short-term financing needs. You should not habitually use overdrafts or use them as a source of long-term funding. You set overdraft terms with your bank and usually have to pay interest.

Advantages

- Overdrafts are flexible—you borrow what you need at the time.
- Overdrafts are quickly and easily arranged.
- You can usually start paying off your balance early without any penalties.

Disadvantages

- There is a charge for extending your overdraft.
- You could be penalised if you exceed the overdraft limit.
- The bank can ask for the money back at any time.
- You can only get an overdraft from the bank where you hold your money.

5. Invoice Financing

Invoice financing is when a third party agrees to purchase your unpaid invoices for a fee. The third party will either provide invoice financing by 'factoring', where the invoice financier manages your unpaid invoices and collects on your behalf, or by invoice discounting, where the financier only provides money up front that you slowly repay as your invoices are paid.

Factoring Advantages

- Your financier will oversee the collection efforts, saving you time.
- Your financier can help you negotiate better terms with your suppliers.

Factoring Disadvantages

- Your customers may prefer to deal with you directly.
- Using a financier may negatively affect your image.

Discounting Advantages

- It can be confidential, so your customers will be unaware that you are working with a financier.
- You still maintain your accounts, which will foster good customer relationships.

Discounting Disadvantages

- You lose profits from orders or services that you provided.
- Financiers will usually only buy commercial invoices, meaning your sales to the public will be ineligible.

6. Leasing and Asset Finance

Rather than owning assets, you can lease or rent them to reduce initial costs.

Advantages

- You get access to goods you could not otherwise afford to own.
- Interest rates are usually fixed.

Disadvantages

- It is more expensive than initially purchasing an asset.
- Long-term contracts can be difficult to cancel early.

Securing the appropriate financing for your business can be tricky. Consult the government's Business Finance and Support Finder at www.gov.uk/business-finance-support-finder, and contact the professionals at **Crendon Insurance Brokers Ltd** to ensure the financial viability of your small business.