

## Finance in a Business

### Key Questions

1. Decide how much money you want?
2. Why?
3. What relationship do you want with the investor?

### Sources of Finance

Source	Advantages	Disadvantages
<b>Overdraft</b>	<ol style="list-style-type: none"> <li>1. Flexible</li> <li>2. Interest Paid on overdraft only</li> </ol>	<ol style="list-style-type: none"> <li>1. Bank can demand repayment at any time</li> <li>2. Will need renegotiation every 6 months or so</li> <li>3. Set up costs (Around 2% for small loans down to .5%)</li> <li>4. Variable, usually pay a fixed margin over base</li> </ol>
<b>Loan</b>	<ol style="list-style-type: none"> <li>1. You have the money, finance is secure (unless you default on payments)</li> <li>2. Match repayments to expected cashflow, maybe possible to have a holiday in the early stages.</li> <li>3. Fixed interest rates (usually)</li> </ol>	<ol style="list-style-type: none"> <li>1. Interest Paid on full amount</li> <li>2. Legally binding covenants that may restrict you ability to raise other finance</li> <li>3. No access to the money that you have repaid</li> <li>4. Security required</li> </ol>
<b>Small Firms Loan Guarantee</b>	<ol style="list-style-type: none"> <li>1. 75% of the loan backed by DTI, less risk for bank so more likely to get finance</li> <li>2. Operated by the banks</li> </ol>	<ol style="list-style-type: none"> <li>1. 2% premium on bank standard rate</li> <li>2. Schemes that create or protect jobs are favoured</li> <li>3. Gradual Business expansion does not usually qualify, need a specific project.</li> <li>4. You have to show commitment by providing some money yourself.</li> </ol>

## ***Minimising costs***

### **Do what you can to improve your credit score.**

Most banks evaluate businesses using a process of credit-scoring. While each bank's system is different, they tend to focus on:

1. How good your security is (see 5).
2. How low your gearing is and how strong your balance sheet is.
3. Putting more share capital (or unsecured director's loans) into the business may reduce the interest-rate margin demanded by the bank.
4. What your cashflow projections are.
5. Your cashflow projections should be credible and should demonstrate that you can comfortably meet interest payments and loan repayments.
6. Your past banking record. (Including your personal banking or other businesses you are associated with).
7. Your business's past financial performance.

How professional your business plan is.

This includes credible commercial plans, not just profit and cashflow forecasts.

How expensive the financing will be for the bank to administer.

It may be cheaper to consolidate all your borrowings with one bank.

### **Ask the bank to calculate and itemise the total cost of any overdraft or loan offer.**

The total amount you will pay over the life of the financing provides a rough guide. For a loan, the total cost of interest and all charges can usually be expressed as an annual percentage rate (APR).

These figures make it easier to compare different offers.

### **Shop around, including alternative forms of finance**

Then negotiate for a lower interest rate and lower charges (even if you have only received one offer of finance).

A bank is usually more willing to improve its offer if you have other quotes.

Your negotiations are more likely to succeed if you have a good credit score or have a good relationship with your bank (see D).

### **Build a relationship with your bank manager, so the bank will be more supportive** if you need additional finance in the future.

Provide periodic management and financial information. Notify the bank of any major business decisions.

## Venture Capital

Conditions	Drawbacks
<ol style="list-style-type: none"> <li>1. Minimum investment of £250,000</li> <li>2. Compound return of 20% to 30% demanded</li> <li>3. Investors want to see major commitment from management team, reward based on performance</li> <li>4. Successful Track Record</li> <li>5. Exit plan in 3 to 7 years for investors</li> </ol>	<ol style="list-style-type: none"> <li>1. Quick return - As the venture capitalist has its own obligations to investors, they are always seeking ways in which to achieve a quick return on investment. This may result in some decisions being made for short term revenue benefit rather than long term strategy.</li> <li>2. Equity dilution - as the number of issued shares increases, so the value of the founder's shareholding decreases proportionately.</li> <li>3. Rapid growth - Although generally an advantage, some companies are not equipped to deal effectively with rapid growth.</li> <li>4. Pressure - venture capitalists will keep the pressure on the management team to ensure that targets and budgets are met. Agreeing to a venture capital investment is definitely not for the faint-hearted!</li> <li>5. Portfolio management - many venture capitalists have a portfolio of several companies and will expect some of the companies to fail as a matter of course. If they decide that your company is one of these they may provide you with very little support and resource or even try to extract value from the company by calling in the loan notes.</li> <li>6. Management conflict - The presence of the non-executive director on the board could cause problems if they do not see eye to eye with the management team.</li> </ol>
<p>Advantages</p> <ol style="list-style-type: none"> <li>1. Size of investment: Venture capitalists can invest large sums, typically between £500,000 and £20 million, which can really enable to business to develop and achieve fast growth.</li> <li>2. Strategy - The investing institution has extensive experience of companies adopting high growth strategies and will often be able to use this experience to help your company grow.</li> <li>3. Market knowledge - Some venture capitalists specialise in a particular market and are able to offer a deep insight into the market and competitors.</li> <li>4. Growth - According to the British Venture Capital Association, venture capital backed companies grow faster than their companies because their principal objective is to build a company to achieve maximum return on their investment.</li> <li>5. Future investment - If investment is required in the future then the venture capitalist can either provide the funding or use their contacts to generate interest elsewhere.</li> <li>6. Management - almost all venture capital companies will put a non-executive director on the board of the investee company who will bring industry knowledge and other management experience to the company.</li> <li>7. Exit - The venture capitalist and the company will agree on a realistic exit strategy before the investment. This provides an incentive for both parties to achieve maximum value.</li> </ol>	

## **Business Angels**

### **Conditions**

1. £10k to £250k given in an equity stake
2. Willing to develop personal relationship. Angels often hands on
3. Average annual return of 20% to 30% expected
4. Demonstrate a strong understanding of product and market
5. Experienced Management team
6. Offer an exit strategy

### **Preparing a Pitch**

1. **Explain your business** to prove that you understand what you are doing.
  - a. Explain what your business does.
  - b. Avoid incomprehensible jargon.
2. Explain what the **key factors to the success** of your business are.
  - a. For example, product excellence or uniqueness, focusing on a specific market niche, or superior customer service.
  - b. Explain how you intend to use the money you raise. For example, to buy new equipment.
  - c. Business angels will be far more interested if you have firm, profitable orders from blue chips, and have invested your own money in the business.
3. Demonstrate that you are offering a potentially **profitable opportunity**.
  - a. Highlight your key financial projections.
  - b. Stress the progress you have made so far. For example, show your previous sales and profits growth, and include references from committed customers.
  - c. Mention any endorsements you have received. For example, an order from a 'blue chip' customer, favourable comments from an authoritative figure, or a good review in a newspaper.
4. Indicate **how much money** you want to raise and what percentage of your business you are willing to sell in return.
  - a. This will help you to filter out angels with insufficient funds or unrealistic expectations.
5. Be **prepared** with the details.
  - a. You should have prepared a full business plan even if you are not making it available to potential investors at this stage.
  - b. You need to be able to justify what you have said and written.
  - c. At a presentation, you should be prepared to answer most questions immediately.

Can take 6 months to become Angel Ready.

[www.AdvantageBusinessAngels.com](http://www.AdvantageBusinessAngels.com) , part of 2WM and West Midlands Partnership.