INNOVATIVE ENTREPRENEURSHIP

Sourcing Finance For Your Business

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Sourcing finance for your Business

This factsheet outlines some of the options available for sourcing external cash to help people start up in business.

Many new businesses fail because they do not have enough cash to keep them alive during their first few months of trading when their sales are generally low and only starting to develop. Before business owner's start trading they need to make sure they have enough money to fund the set up the business and cover initial running costs. If they don't have enough money themselves, they will need to look for other sources of finance.

There are various sources of finance available, but for new start-ups, the most likely options will be:

- Personal savings and informal loans from family or friends
- Bank loans and overdrafts
- Credit cards
- Private equity investors
- Venture Capital
- Grants from other independent business support organisations and schemes.

Personal savings and informal loans from family or friends

Friends and family may be prepared to help start-ups by offering them a loan, particularly if it has not proved possible to get one from a bank. This may be on preferential or 'soft' terms, including the possibility of an interest-free loan. If friends and family offer a loan, but require interest to be paid, then there may be tax implications for both parties. In addition, personal relationships may be affected if the business does not do as well as planned and the business owner is unable to repay the loan on time or in full.

Relatives or friends may also consider investing money in a business in return for a share of its ownership, even if they act as a 'sleeping partner'. However, they need to understand that they will be risking their capital and that returns are not guaranteed, so they should invest only what they can afford to lose. This type of investment may also have implications relating to the legal standing of the business.

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Bank loans and overdrafts

Banks offer a variety of finance options, services and introductory offers to business start-ups. For example, many banks offer an introductory period of free banking, and this can last for up to two years in some cases.

Overdrafts

Banks can provide finance in the form of an overdraft, whereby they agree to let business owners withdraw more money than they actually have in their business account. The bank will set a maximum level for the overdraft. Businesses only have to pay interest on the amount they are overdrawn, so overdrafts can be a good option if only small amounts of extra cash are needed at certain times during the month or year. However, the interest payable is often higher than the rate for a loan.

Loans

Business loans are available through the main banks; however it is important to shop around for the best deal for both personal and business circumstances. Factors to consider include the amount to be borrowed, the rate of interest charged and the repayment period that is affordable. For a business start-up, it is likely that the loan will need to be secured against a personal asset such as the proprietor's house or other property.

Credit cards

Some business start-ups fund their short-term spending through the use of credit cards. This has been encouraged by the availability of competitive deals such as introductory interest-free offers. While many credit card providers discourage the use of personal credit cards for business purposes, there are now a number of credit card offers specifically targeted at new business owners.

Credit cards can help a business to finance its short-term needs, but they don't make sense for long-term borrowing. Although initial interest rates may be attractive, the interest costs of credit cards are usually higher than overdrafts and loans, unless the business owner can repay the outstanding balance each month.

There are also practical advantages of using business credit cards. This is a good way of separating personal and business expenditures. The credit card statement can be used for accounting records and helps tracking of costs. Most of the cards provide reward system and the business may benefit from these rewards and other free of charge or discounted services provided to that particular card membership. If you get a business credit card, you'll likely have a business credit score. The upside is that if you use your card responsibly, you could improve your score and get lower interest rates in the event you need to take out a business loan.

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Private equity investors

Private equity is money that is invested in a business by a third party in return for a share of the ownership. This may be provided by a commercial organisation such as a venture capital firm or private investors who are known as business angels. This type of finance is available only to limited companies. Private equity funding is not available for start-ups that operate as a sole trader or business partnership legal structure.

Private equity is not usually secured on a company's assets, so the investor faces the same risks as the other shareholders. If the business fails, they will lose their money. Investors achieve a return on their investment through the payment of dividends by the company and the value they achieve for their shares when they are sold.

Venture capital

Venture capital is a means of financing a business where a proportion of the firm's share capital - or equity - is sold in return for a cash investment in the enterprise. It means that some measure of control or ownership over the business has to be given to the new shareholder. Most, but not all, venture capital investors are looking to make quite large investments, often over several million TL, which excludes them from providing finance to the majority of start-ups.

Grants from other independent business support organisations and schemes

Grants provide finance to allow a business to undertake a specific project that, without financial assistance, would not be able to proceed. Such projects might involve the initial start-up of the business, developing a new product or buying equipment. A grant is usually a one-off payment and provides funding that covers a percentage of the costs of the project - normally the proprietor or the business will have to meet some of the costs too. Unlike a loan, a grant does not usually have to be repaid unless the business fails to comply with the specific eligibility requirements and conditions of the scheme. Business owners need to check they meet the eligibility criteria for a particular grant and consider what will be required to satisfy the funders' requirements.

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