Christopherson Associates

Guide to

RAISING FINANCE FOR SMALL COMPANIES

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PRACTICAL SERVICES *for* BUSINESS DIRECTORS

There are over 4 million registered businesses in the UK, 99.3% of which are defined as Small Medium Enterprises (SMEs).

SMEs find it significantly more difficult to raise the funds required to either start or develop their business than their larger corporate cousins. 98% of their funding applications fail.

So let us first consider what you might want funding for.

Seed Capital

This you would need before you have any revenue coming into the business. You have a good idea and the requirement is to prove the concept; usually less than £50,000 would be required.

Proof of concept funding is difficult to raise. Friends and family, grant funding and specialist incubation funds are the preferred sources of funding at this stage.

Start up Capital

You have developed your business plan including market and financial planning and you have started to recruit your management team and are able to start generating revenues.

Finance of between £50,000 and £500,000 is required for marketing and operations to get the business up and running.

There are three probable sources at this stage: equity, debt funding and grant funding, further details of which we will come onto shortly.

Expansion Capital

You have an established business, which has the opportunity to grow organically or by acquisition, and you need to raise additional funding, over £100,000, to support this growth.

Again equity, debt and grant funding can all come in to play, but it is more often debt funding in one of its various forms that is the most likely source.

Where the figure required is in excess of £1m, there are an increasing number of specialist investment funds who deal in this type of funding.

Now let's review those different sources of funding.

EQUITY

Private Investors: Can include family, friends and/or Business Angels. Business Angels are high net worth individuals either operating alone, typically investing £25,000 to £100,000, or in groups where the equity requirement is greater. Their investment criteria vary considerably and you should seek investors who will bring considerably more to your business than just money, in the form of their experience and networks. Typically Business Angels will want to take a non-executive role within your business and will be seeking an exit for their investment within 3 to 5 years. Most will be seeking returns of between 5 to 10 times the original investment and will want to benefit from tax relief under the Enterprise Investment Scheme (EIS).

Regional Venture Capital Funds: There are a number a small regional venture capital funds supported by the Government, which are aimed at the SME market. These funds receive hundreds of applications each year for funding of which less than 2% are successful.

Seed Funds: Many of the seed funds are associated with university incubation centres and therefore focus on technology and innovation. For example NESTA (The National Endowment for Science Technology and the Arts) can invest up to £250,000 in innovation start-ups.

Venture Capital Funds: Traditional venture capital funds are unlikely to invest below £2m and therefore tend to be of little interest to the SME sector.

DEBT

Small Firms Loan Guarantee Scheme (SFLGS): Available through most main high street banks, in which the Government guarantees 75% of the loan against an insurance premium of 2%, with the lender taking the balance of the risk. The lending premium over base will typically be 3.75% and you will incur a 1.5% arrangement fee. SFLGS's need approval from the DTI and are only available to companies that have been trading for less than 5 years, where the shareholders have already pledged significant personal assets and the business operates in prescribed industry sectors. The willingness of lenders to support SFLGS applications vary from lender to lender and from manager to manager.

Bank Loans/Overdraft: If you are ineligible for a SFLGS loan, you may be able to obtain debt-funding via your bank, but you will be required to provide one or more of the following; Directors Guarantees, Debenture and possibly a Personal Guarantee. Agreement fees will typically be 1.5% with the premium over base in the range of 2.5% to 5%.

Asset Financing: Hire purchase, finance lease and contract hire can be used to fund the acquisition of certain categories of assets.

Invoice Financing: This is where a finance company or bank buys your debtors and pays you up to 85% of the invoice value. The balance is paid to you once your customer has paid the invoice. You can either continue to undertake the credit control and cash collection directly, or out-source this activity completely to the finance company or bank. You will be charged a monthly fee to cover administration, typically in the range of 1% to 1.5% of the average monthly invoicing value and the premium over base will normally be in the range of 2% to 3.5%.

GRANTS

There are a number of grants available from a wide range of different sources, although the application process can be lengthy and time consuming. All have various criteria that need to be met, such as location (development areas), purpose (technology, training, etc), sector (innovation, environment, etc) and personal (unemployment, etc).

WHAT ARE MY CHANCES FOR RAISING FUNDING?

Whether you are seeking to raise equity or debt funding, you will need to present a business and financial plan, which clearly underpins your investment or lending proposal. Broadly speaking this is what happens to investor/lending proposals:

- 60% are rejected immediately
- 25% are rejected after a face to face presentation
- 10% are rejected after further evaluation
- 3% fail at the negotiation stage
- 2% succeed in raising the equity or debt funding

WHAT ARE THE MAIN REASONS FOR INVESTORS/ LENDERS TO REJECT PROPOSALS?

- Poor presentation for the business proposition
- Financial forecasts are poorly constructed with weak assumptions
- Weak cashflow
- No track record for the management team
- Lack of commitment from the management team
- No clear exit route

WHAT ARE THE MAIN BENEFITS OF EQUITY?

Medium to long term funding with no interest costs or repayment schedules. Shareholders may agree to a dividend policy in the event that cash flow and company reserves enable payments to be made.

Equity investors can/should bring experience and networks as well as funds.

Bank lenders will require equity investment before agreeing to advance debt.

WHAT ARE THE DRAWBACKS WITH EQUITY?

Early stage investors will be seeking annual returns of up to 40% to cover their risk; therefore this is an expensive source of funding in the medium to long term. This annual return will reduce for later stage businesses.

The search for the right investor is time consuming and difficult. Typically it will take 6 to 12 months before cash is received from an investor, whereas the bank lending process can be considerably shorter.

Personal chemistry is always difficult to assess during the early meetings.

Shareholding dilution with potential differing views regarding valuation.

WHAT NEEDS TO BE IN THE INVESTOR/ LENDING PROPOSAL?

The business plan will vary slightly depending on whether you are seeking equity or debt funding. The plan should be concise (no more than 20 pages plus financial schedules) and should have the following structure:

- Executive summary
- History
- Market opportunity
- Product offering and product development
- Intellectual Property Rights (IPR)
- Manufacturing or sourcing strategy
- Competition and competitive advantages
- Routes to market
- Risks and threats
- Management team and organizational resources
- Financial assumptions
- Financial plan
- Sensitivity analysis
- Exit route for equity investors

Your business plan MUST NOT:

- Over-sell the business opportunity
- Forecast sales that are over optimistic; they should always be conservative and not based on straight line projections
- Be overly complex with over emphasis on technical or management jargon
- Discount competition

Christopherson Associates Business Funding Services can advise on the best types and sources of funding for your business and help you prepare your business so that your application has the greatest chance of success.

Our extensive range of contacts within all the necessary lending institutions and access to a significant number of business angels ensures the best sources of finance are available to our clients.

If you are interested in any of our Business Funding Services please telephone us on ***01225 480325*** *or complete the contact form on our website* ***www.practicalservices.co.uk*** *to arrange a free discussion.*

The author of this article is available for group presentations to your business or organization. If interested, please call us on ***01225 480325*** *to arrange.*

See the downloads section of our website for similar guides for small business owners.

About Christopherson Associates

Christopherson Associates help business owners achieve their goals by providing a whole range of practical services.

These services include boosting profits, increasing sales and marketing activities, streamlining operations, installing Quality or IT systems, ensuring compliance with Health and Safety regulations or Employment legislation, raising finance, planning and implementing an exit strategy or helping with any business problem outside of the experience of the business owner.

All our associates are seasoned and mature business professionals with decades of relevant business experience either at board or director level of major companies or have run their own businesses.

They are well trained in working with business owners and take a highly practical approach to solving problems and enhancing your business by working closely with you every step along the way.