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Funding Methods Explained:
Your Essential Guide to Business Finance

Hilton-Baird Financial Solutions

Cash Is King

With the success of any business reliant on a healthy cash flow, making sure you have the most suitable funding in place for your evolving needs is crucial. And with business confidence ever increasing it only seems natural that business owners will be making bolder investment decisions in order to expand and move to the next level. But, with so many finance options available, it can be hard to decipher which method is best suited to the needs of your business.

Existing cash flow, business credit cards and bank overdrafts came out on top as the most common methods of funding currently used by businesses, according to our SME Trends Index 2014.

Our research also revealed that half of SMEs turn to their bank manager for support when seeking a new funding facility. Whilst not surprising, this could mean that SMEs aren't gaining the full picture of what is available out there for them and subsequently could end up tied into a financial facility that doesn't meet the specific needs of their business.

This guide explores the many finance options available to British businesses and their benefits to help your business to pin down a robust funding strategy that will work over the long term.

Overview

Spread the word

Hilton-Baird Financial Solutions is passionate about helping companies to access the funding that's vital to their growth and success. If you find this eBook helpful, please share it with your peers.

Asset based finance releases cash against the assets on your balance sheet. More and more businesses are realising the benefits associated with asset based finance and the amount accessed through this form of funding has grown rapidly in recent years.

A RECORD

£18.9billion

of funding was provided to UK businesses in Q2 2014 according to the Asset Based Finance Association (ABFA)

Our research also found that businesses using invoice finance or asset finance to fund their company are outperforming their peers in terms of profitability, turnover and business confidence.

For more on these results please click here...

The most prominent form of this funding is invoice finance.

Invoice Finance

The basic premise behind invoice finance solutions is that they allow you to bridge the cash flow gap between providing a service or supplying a product and being paid. Such funding enables you to access this cash tied up in your sales ledger within 24 hours of issuing invoices.

Typically up to 90% of the value of the invoice is advanced and the balance is paid to you once your customer's payment is received, minus fees.

Whilst many variations are available, the two main forms of invoice finance are **factoring** and **invoice discounting**. Invoice finance can be tailored to the specific requirements of the business to include the following options:

- Debtor protection for peace of mind
- Dedicated credit control expertise
- Confidential basis
- International capabilities

To find out how factoring and invoice discounting works please click here...

Pros

- Invoice finance is more flexible than traditional finance as the cash you can access grows in line with your sales ledger.
- By boosting your cash flow in just 24 hours, invoice finance allows you to bridge the cash flow gap between paying suppliers and receiving payment from your customers.
- Invoice finance can enable your business to negotiate supplier discounts.
- Credit control can be built into the invoice finance solution.
- Debtor protection can be added.
- Unlike a bank overdraft, invoice finance solutions cannot be recalled on demand.
- Invoice finance can be used to leverage funds for M&A activity.

Cons

- Better suited to certain industry sectors.
- Only for B2B and those trading on credit terms.
- Previously viewed as 'lending of last resort', although this perception has largely been overcome.

Asset Based Lending

Asset based lending typically has an invoice finance facility at its core, but also releases funding against a range of additional assets on the balance sheet, including property, plant, machinery and stock.

"Invoice finance has been the ideal facility for us, helping to fund our cash flow and enabling us to grow at the rate we have. We couldn't be happier."

Peter Doyle, Managing Director, NXP Europe Ltd

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Asset finance solutions overcome the cash flow challenges posed by purchasing new equipment, plant or machinery. These solutions can also be used to release cash from your assets.

There is a range of asset finance options available from a variety of providers, so it is important to explore the benefits of each one to ensure you get the right solution for your business:

Hire Purchase

Hire purchase allows your business to hire an asset from a leasing company over a fixed period of time in return for regular payments. The hire purchase company buys it on your behalf and, once the repayment period of the hire contract is over, your business will have full ownership of the asset.

Finance Lease and Operating Lease

Both finance leases and operating leases allow businesses to use an asset for a fixed period in return for regular payments. You will not own the asset outright at the end of the repayment period, although an extended lease could be negotiated if needed.

Asset Refinance

Asset refinance provides a vital cash injection to help your business overcome any cash flow problems as you sell equipment to an asset finance company, who then leases it back to you in return for regular rental payments.

Vendor Finance

Vendor finance allows your business to purchase an asset from the seller over a specific period. The vendor forwards a percentage of its value which is paid back in regular instalments.

Import Leasing

Import leasing offers a means of financing the purchase of any assets from overseas while the asset finance company also specialises in international business management.

Pros

- Asset finance allows businesses to purchase new plant, machinery and equipment whilst protecting their cash flows.
- Asset refinance releases capital against currently encumbered assets.
- Equipment can be leased for a short period if only required for a limited time.
- Finance leases and operating leases avoid the issues relating to asset depreciation.
- Equipment can be purchased domestically or overseas through asset finance.
- Asset finance avoids the need to sell at a second-hand price when upgrading the asset.

Cons

- Only suitable for businesses that use plant, machinery and equipment.

Popularised by the BBC's Dragon's Den television show, equity finance sees businesses gain investment from business angels and venture capitalists in return for a share of the company. In addition to the funding that's provided, a major advantage is the input and expertise offered by the investor, who will help to drive the business forward.

Business Angel Investment

Business angels provide new business funding to help fledgling and growing businesses get off their feet. Business angel investment supplies private equity to companies seeking up to £2million of seed capital to boost the business' cash flow.

Venture Capital

Venture capital companies invest private equity to firms seeking a minimum of £2million, whilst further providing valuable insight and business support to make it easier to source other funding solutions.

Growth Capital

Growth capital provides capital investment in return for a share of the business to specifically help your company to expand, supplying additional capital to fund any mergers, acquisitions, management buy-outs and management buy-ins.

Turnaround Capital

Turnaround capital supplies equity finance to help a business to overcome cash flow problems that are threatening its immediate financial security. The venture capitalist additionally provides support and financial management to assist the company going forward.

Pros

- Unlike a business loan, which is repaid on a monthly basis, private equity companies earn dividend payments, ensuring their commitment and dedication to boosting your company's success.
- Private equity investors provide expert advice and business support to help run the business, in addition to releasing seed capital.
- How much control the business angels or venture capital companies have depends on the terms of the contract agreed in advance. As a rule of thumb, the more they invest the higher the share an investor will expect.
- Turnaround capital additionally provides equity finance to boost the company's cash flow.

Cons

- You hand over a stake in your business in return for the equity.

Overdrafts

When cash flow is tight, overdrafts give businesses a flexible way to manage short-term borrowing. Available in two forms – planned and unplanned – overdrafts allow you to pay for something when you would otherwise have no money in your bank account.

But overdrafts are subject to application and approval and are repayable on demand, making them an unsuitable funding option for many businesses.

Pros

- You only borrow what you need at the time which may make it cheaper than a loan.
- It's usually quick to arrange.
- Banks don't normally charge you for paying off the overdraft earlier than expected.

Cons

- Overdrafts aren't particularly flexible and if you have to extend your overdraft, you usually have to pay an arrangement fee.
- Your bank could charge you if you exceed your overdraft limit without authorisation.
- The bank has the right to ask for repayment of your overdraft amount at any time.
- Unlike loans, you can only get an overdraft from the bank where you maintain your current account.
- The interest rate applied is nearly always variable, making it difficult to accurately calculate your borrowing costs.
- If you don't use your overdraft, it may be reduced at short notice.

Credit Cards

According to our research, 47% of businesses currently use business credit cards and 12% use personal credit cards to fund their activity. Credit cards can provide instant access to funds but could leaning too heavily on this form of credit prove risky?

Pros

- With traditional bank lending in decline, credit cards offer an easier and faster way for business owners to access credit, especially those who do not have a well-established credit history.
- Whatever you need to purchase, credit cards grant you quick access to cash. Also, with the growing popularity of online trading, credit cards make online transactions easier.
- Most credit cards offer online tools which can help track, categorise and monitor expenditure, making bookkeeping simpler.
- Using a credit card responsibly can be a good way to build a good credit rating.

Cons

- Credit cards often work out to be expensive as the interest you pay can add up quickly if the balance is not paid off each month.
- Credit limits are fixed which could become a problem if your business circumstances change and you need to access more funding.
- Going over your credit limit will impact your credit score and could affect your chances of securing finance in the future.
- Providers are able to reduce credit limits with little notice.
- Credit cards are based purely on ratings and lack a deeper understanding of your business and its cash flow fluctuations, therefore may not be able to provide the flexibility or support you require.

Credit Insurance

Although not strictly a funding solution, credit insurance is no less important in the current climate that's riddled with late payment. Facilities will safeguard your business against late or non-payment, either through debtor insolvency or protracted default, and can be provided as a standalone product or as part of an invoice finance facility.

Find out more...

Payroll Finance

Payroll finance helps to overcome the cash flow challenges associated with paying wages by advancing the funds to cover this, in addition to the tax and National Insurance contributions. Facilities can also incorporate a back office outsourcing function. Payroll finance can be secured alongside other cash flow finance solutions.

How could payroll finance help?

Property Finance

Your property may represent one of a business's largest assets – make sure it's being funded effectively. There are a range of business property finance solutions available from commercial mortgages to sale and leaseback.

Whilst sale and leaseback facilities allow your business to release cash against your assets, remortgaging your commercial property will help to reduce overheads. Also, property development loans assist with the expansion or redevelopment of your premises.

Find out more...

Government Initiatives

There is a range of government initiatives focused on helping SMEs to access funding to stabilise and grow. The Enterprise Finance Guarantee (or EFG) provides loans of between £1,000 and £1 million to SMEs. With the government 'guaranteeing' up to 75% of the loan, it lowers the risk to the funder and can be used to support new loans, refinance existing loans or to convert all or part of an existing overdraft into a loan that is repayable over a period of up to 10 years. Other government initiatives include the Start Up Loans Scheme, UK Export Finance and GrowthAccelerator.

Does your business meet the criteria for the EFG?

Trade Finance

Trade finance solutions are extremely useful for businesses who export or import. They help to bridge the payment gap commonly experienced with trading overseas, and can additionally provide support with language and cultural differences when collecting monies owed.

More about the options available...

Stock Finance

Your unused stock can tie up a lot of cash. Stock finance will release funding against the value of raw materials, work in progress or finished goods. It can be provided as a stand alone facility or as part of a wider asset based lending facility that incorporates invoice finance.

Find out more...

Peer-To-Peer Lending

Peer-to-peer lending matches borrowers with savers willing to put money aside for longer, hunting for a good return. As the banking middle-man is cut out, borrowers often get slightly lower rates, while savers get far improved headline rates, with the sites themselves profiting via a fee.

Crowdfunding

Crowdfunding is a great option for startups and early stage businesses. You "pitch" your idea or business to potential investors and, if interested, they will contribute a sum to the proposed venture. Then you decide how you want to reward those who helped you make it happen.

Conclusion

No two businesses are the same. Each has its own unique, and often complex, funding requirements.

Finance is most certainly not a 'one size fits all' offering and with so many solutions on the market, the search for the right funding facility or facilities can prove to be a challenging process.

We hope that this guide has provided useful information to help you identify the right solution for your business. However, if you're still finding that the search for funding is consuming valuable time and resource from your core business, we may be able to help.

At Hilton-Baird Financial Solutions we will work with you closely to fully understand your business's funding needs and challenges in order to identify the right facility. Our expert knowledge of the market will ensure the most suitable funding facility for your business.

To talk to our team about your specific requirements, call 0800 9774833 or email info@hiltonbaird.co.uk.

Six reasons to use a broker

1. *Efficiency*
2. *Independence*
3. *More choice*
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Hilton-Baird Group

+44 (0)2380 707 390
+44 (0)2380 707 391
info@hiltonbaird.co.uk
www.hiltonbaird.co.uk

Woollen Hall
Castle Way
Southampton
Hampshire, SO14 2AW