A BRIEF GUIDE TO FUNDING FOR START-UPS

OVERVIEW:

The vast majority of business funding falls into 2 categories, being described as either debt or equity.

Put simplistically, debt funding is repayable – albeit potentially with no particular timescale, whereas equity rewards the provider with a share of the business.

The above apply to virtually all money put into a business, including money from the owner's own savings.

Exceptions to the above are grants and social/reward-based funding. Since both are a very small part of the picture we will cover them briefly.

GRANTS:

Invariably grants have some form of social payback, whether that be environmental, economic, innovative, social or political (or potentially others).

For this reason, they tend to be very user-specific so it is impossible to create a meaningful guide to grant funding.

At the time of writing there is no such thing as a 'start-up grant'.

In addition to social pay-back, there are often 'strings attached', such as matched funding.

SOCIAL / REWARDS-BASED FUNDING:

This is a non-specific area, where funding provider gets their pay-back either through the 'feel good factor' of having helped a cause, or in rewards usually linked to the business itself – which might be tickets to events, free/discounted product, special access or similar.

Being non-specific, there are no actual providers of this type of funding, though it is most commonly associated with crowdfunding.

CROWDFUNDING:

To dispel a couple of myths:

1. There is nothing new about crowdfunding – in fact educational and religious establishments have been using it pretty much since the dawn of time.
2. It isn't an easy way to get funding where everything has failed.

On the other hand, what is new is the availability and accessibility of multiple platforms on which to pitch your offer, leading to its wide acceptance as a way of funding business growth.

And it can yield phenomenal results if done properly - look at companies like Brewdog & FreeAgent to see how it can work.

Key steps in successful Crowdfunding are:

Build a strong and loyal crowd**.** People who support your brand, your ethos or even just you. Crowd-building should take place well before a campaign is launched. Almost all successful crowd-fund campaigns follow brand-building exercises.

Get a key sponsor. A big hitter – either in the public domain, supporter of your cause or a big industry name, to get the ball rolling with a contribution and/or endorsement.

Put something in yourself. It doesn't have to be hard cash, it might be IP or even just hard graft.

Choose an appropriate offering. Whether that is debt, equity, or rewards.

Choose the right platform. With literally hundreds to choose from, you need to select the platform best suited to your product, crowd and reward-type.

So, as I say, it isn't easy, but it can produce spectacular results if done well!

OWN MONEY – FFF:

Where FFF refers to '*friends, family & fools*'.

Naturally it makes sense to use what is immediately available to you, and in many cases sources of external funding will expect you to have done exactly that.

A BIG caveat here is that money your and your friends have worked hard for isn't '*free money*' – it must be introduced as either debt or equity, and treated in the same way as institutional investors /lenders – to be returned in good time and with appropriate yields. Not doing so is basically creating a financial fools' paradise.

In fact, you can really view this type as funding as a micro version of crowdfunding.

BOOTSTRAPPING:

The most basic form of getting a business off the ground is bootstrapping, in other words, using what is around you or simply doing without.

Even in a business which requires up-front investment, such as a hotel or manufacturing plant, looking at ways to do without, to cut costs or simply to postpone expenditure can be a great exercise and can give you time to evaluate where money is best spent.

There is often an element of fooling yourself around the value of your time, or of other people's resources, but it is well worth considering which aspects of your business can effectively be bootstrapped.

EQUITY FINANCE:

This is where funding is granted in return for a slice of the business (as seen in Dragons' Den).

Equity finance is typically split into Angel Investment & Venture Capital; where the difference lies mainly in the size and relative formality of the arrangement.

Equity investors see their returns in terms of:

- Exit payment (sale of shares), which might be by sale, management buy-back or float.
- Dividends against profits.
- Fees and charges.

One key – and often overlooked - aspect of equity finance is that it is far more than a financial arrangement, investors will want a degree of involvement, ranging from being sent annual accounts right through to regular attendance at meetings and even their own office on site.

Experienced investors can bring a lot to a business by way of contacts, insights and experience, but for the relationship to work they need to be embraced as partners, not viewed as intruders.

Equity finance is most useful where rewards are some way in the future but are potentially big – such as development of a new technology or dynamic roll-out of a retail brand.

A common misconception is that investors are mostly interested in your idea or product. In fact they are looking very much at the person/people & the business itself.

Investors like to talk about 'skin in the game', meaning what you have brought along or what you stand to lose if it goes wrong (they are there to share the risk, not to take it all). Often this is cash you have introduced, but could take other forms, such as IP, contracts, equipment etc.

Take another look at Dragons' Den and pay attention to the recurring themes!

BANKS:

Banks are notoriously reticent when It comes to funding start-ups, however at any given time they might be offering smallish loans or overdrafts on fairly soft terms.

In any case, it is worth having the conversation to see what is on offer.

Principal bank offerings are:

- Overdrafts
- Term loans
- Mortgages

They will usually require a charge over bricks & mortar property on larger transactions.

Your bank might also point you towards their own asset finance or invoice finance provider.

TYPES OF FINANCE:

There are no *'right/wrong'* or *'best/worst'* funding products – the best solution for you will be determined by your own business needs and circumstances, and what you have to offer by way of security. Your business plan and detailed cashflow projections should provide useful insight to decide on the type of funding most appropriate for you.

Funding facilities available to start-ups include:

Start Up Loans. A dedicated, Government-backed facility provided through the British Business Bank.

It takes the form of a personal loan up to £35K per person (£70K per business) over term up to 5 years.

They require a relatively clean personal credit history, the deal itself is underwritten entirely on the quality of the business plan.

Unsecured Business Loan: Typically delivered through mainstream banks. As stated above, these are hard to access for start-ups.

A common misunderstanding is that 'unsecured' means there will be no Personal guarantees. In fact the 'unsecured' means there are no charges over assets. Personal guarantees will almost certainly be required.

Unsecured loans are usually offered for fixed terms between 2 and 5 years.

Secured Business Loans: If you have property or other valuable assets to offer as security, then there are a number of lenders who will offer secured loans supported a charge over assets.

With the comfort of additional security, secured loans might be for as much as 10 years.

The process is somewhat slowed and charges will be incurred for valuation and legal work.

Any reputable lender will recommend that you take legal advice before taking a secured loan.

Overdraft. Previously the mainstay of business finance, banking regulations have made banks less enthusiastic about offering overdrafts.

Overdrafts are beneficial where the need for funding comes in either regular short spikes, or in specific periods, such as Christmas shut-down.

If the overdraft is in full-time use you should consider a term loan.

Asset Finance. If you are buying fixed assets – anything from cars to computers, from machinery to office refurbishment, then asset finance is an option to consider.

In most cases asset finance will take the form of either hire purchase or lease. (Car finance is more complex and comes in many formats).

The majority of asset finance deals are done on fixed rate over 2 to 5 years, though for heavy equipment or larger transactions other terms might be available.

Invoice finance. If you are selling to businesses, they might require credit terms – sometimes 30 days occasionally as much as 120 days. An invoice finance facility will enable you to borrow money against outstanding invoices.

This might be set up against ad-hoc individual invoices or against the whole of your debtor book.

In its broader form, usually referred to as factoring, an invoice finance arrangement can be all-encompassing, including offering full collections facilities and credit insurance.

*****Credit control is a topic on its own and is essential if you are going to offer payment terms.*****

Purchase finance. This very specialist facility can be used by businesses with firm orders from strong companies who require funding to buy stock to fulfil the order.

Your projections will give valuable information to establish the need, the amount and the type of finance which is suitable for you