BeTheChange
Boosting entrepreneurship through intergenerational exchange

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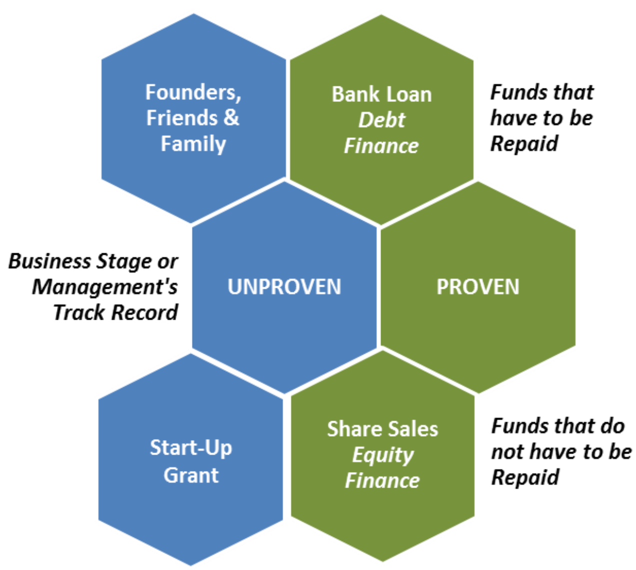
5.20 Raising Business Finance

INTRODUCTION

Raising Business Finance is not easy and the pre-requisite is a Cash Flow Forecast for the business that predicts what money will come into the business and what money will go out of the business over s certain period. For most new businesses (especially those set up by self-employed, 'First-time Founders') that period of time will typically be one year. For more mature businesses or those founded by a Management Team with a proven track record then the period may well be three years since any longer is always difficult to predict with confidence for any business. The following figure illustrates the four, main forms of business finance relevant for a new business.

FORMS OF BUSINESS FINANCE



As will be seen above, the key components are grouped in terms of the 'Unproven' business (blue) and the 'Proven' business (green). Unproven means a business that has not yet started trading or one that is being launched by Founders without a track record in business.

By contrast, 'Proven' means a business that is already trading successfully (means it makes a profit) or a new business being launched by an experienced Management Team that has a proven track record of success in business. The reason for making this distinction is that Financiers treat Unproven and Proven businesses differently; we'll look at differences later but for now, let's review the different forms of business finance.

FUNDS THAT HAVE TO BE REPAID

Funds that have to be repaid are essentially loans – see the top two hexagons opposite. Now loans can come from people that know you (Founders, Friends & Family or 'FFF') or people that don't know you very well… mainly people in banks. FFF loans can be very flexible in terms of when repayments start, what period repayments are made over and what interest (if any) is paid by you. Bank loans are different. These will have very tight and often inflexible terms set by the bank. The terms may vary a little between different banks but most will be broadly the same. In addition, the banks are likely to ask for (i) the Founders to put in some of their own money and (ii) a form of security in case things go wrong such as a charge over the Founder's house if the new business has no assets to secure the loan.

FUNDS THAT DO NOT HAVE TO BE REPAID

Funds that do not have to be repaid - see bottom two hexagons opposite - are essentially gifts or mean selling a portion of the business to an investor. The sale of 'shares' in a new business relates only to a Limited Company and is termed 'Equity Finance'. Any new business should always look for Start-Up Grants and there are a number available in Malta; the best people to speak with in Malta are Government support bodies such as Malta Enterprise.

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THE UNPROVEN BUSINESS - STRENGTHS

By the very nature of the business being unproven, that may qualify it for Local, Regional, National or even EU funding schemes and grants aimed to help start-ups. In addition, Friends and Family may wish to support someone they care about and help them to start a business with a flexible loan. However, the business still has to be based upon a good idea with a sound business plan and a realistic cash flow forecast.

THE UNPROVEN BUSINESS - WEAKNESSES

The unproven business will not have made significant sales and its forecasts about future sales may be considered unreliable (at best) or, as is often the case, over-optimistic (at worst). In either case, a lack of confidence in future sales may lead bankers to conclude that the business would not be able to make repayments on a loan and hence refuse a loan application. In addition, an unproven management team (especially a single founder) may be considered as 'risky' and hence the bank is likely to ask for some kind of security with which to secure any loan. And for young people in particular, who are unlikely to own their own home, they may not have suitable assets with which to secure a loan.

Equity finance is even more problematic. For an investor (often called 'Business Angels') to buy shares in a company they need to be convinced that the business has a strong chance of growing very substantially. And the Founder(s) must have an 'Exit Strategy'; that is to say, a plan to sell the business within five years (typically) at a higher valuation such that the investor makes a 'capital gain' by selling the shares at a higher price than they were bought for. To make matters worse, investors like to back experience management teams that have track records of success is doing this kind of thing before. A single, unproven Founder is therefore unlikely to meet their requirements.

THE PROVEN BUSINESS - STRENGTHS

A proven business may be one that has been established for a few years and whose accounts indicates that it is profitable. In addition, if the sales revenue and profitability is seen to grow year-on-year then bankers will be confident that reasonable loan repayments could be made. Furthermore, such a growing business is likely to have a good 'purpose' for the loan such as the need for 'working capital' to help fund growth; banks will look more favourably on loan applications in these situations. In addition, if the management team has a good track record then the bank will gain additional confidence that the business will be able to deliver what is written in the business plan and the cash flow forecast. A proven management team may also attract investors who would buy shares in the company and hence provide equity finance for the business.

THE PROVEN BUSINESS - WEAKNESSES

It may be that banks will expect a proven management team to put in some of their personal funds (presumably obtained via previous business success) as a contribution towards the amount required. Banks like it when the business owners 'back themselves' in this way as it is seen as sharing the risk with lenders. It would not be unusual for a bank to expect 30% of the amount required from the owners to match 70% from the bank.

CONCLUSIONS

Raising business finance is not easy. Please remember that banks are not in business to take risks and that they never share in the financial success of a business – they only get the loan repayments plus interest. Equity finance is not for the amateur. But one other route to explore might be reward-based crowd-funding; in Malta take a look at the **ZAAR.com.mt** website for details of how those schemes work.