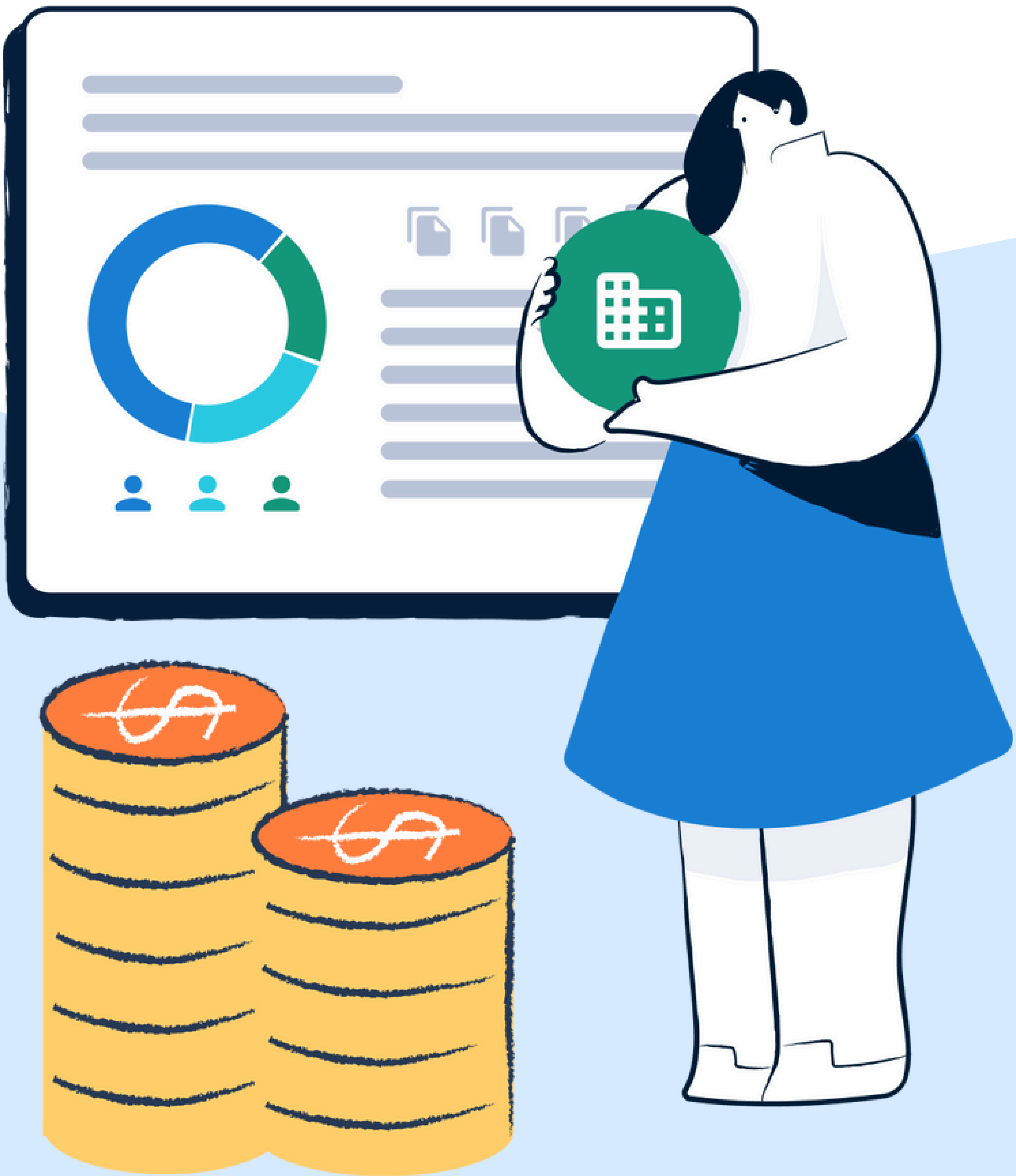
Financing Your Business



Lawpath

Contents

Chapter 1: What is Business Finance?

Your Business FinancingOptions 5
The Right Type of Funding 5
Questions to Ask Yourself 6
Funding Fishooks 7

Chapter 2: How Much Funding Do You Need?

Business Budgeting Tips 9
Starting a Business 9
Buying a Business 10
Running a Business 10
Growing a Business 11
Get an Accountant to Look at Your Numbers 11

Chapter 3: Debt vs Equity Finance

Growing a Business 13
The Finance You Choose Matters! 14

Chapter 4: How to Get a Business Loan

Types of Loans 16
What is a Line of Credit? 17
How to Apply for a Loan 18
Types of Lenders 19
Invoice Financing 23

Chapter 5: How to Find Investors

Types of Investors 26
Are you Ready for Equity Finance? 27

Chapter 6: Small Business Grants

What is a Small Business Grant? 31
Sure & Steady: Early Growth Phase 32
Bigger & Better: The Expansion Stage 32

Chapter 7: Pitching for Business Funding

What to Demonstrate in Your Pitch 34

Looking for More? 35

What is Business Finance?

Is your new business idea ready to go? Or perhaps you're ready to grow your current business? If you don't have the deep pockets to finance it yourself, you'll need to find the right small business funding. But where, exactly, do you start?

Your business financing options

Most small business funding falls into one of two categories:

1. **Debt** – where you borrow an amount of money and pay it back, usually with interest.
2. **Equity Finance** – where you get funds by selling a share of your business to investors.

You may end up with a mix of both, but keep in mind that there are many types of finance within these main categories.

What's the right type of funding for your business

Some types of funding are faster to get than others, some require more security, some are cheaper, some come with strings attached. You need to know what type is going to be best for your situation. It's important to find funding that fits. You don't want your financial arrangements to get in the way.

Ask yourself these business finance questions

Before you go knocking on doors, there are a few steps you can work through to help you pick the right type and quantity of funding:

What are you funding? A start-up? Buying a business? Expanding an existing one? Are you looking to solve a cash flow problem? Some funding types are better suited to different needs.

How much do you need and what will you spend it on? Knowing how much you need and where it's going to be spent will narrow down the best option for funding.

Are your finance needs short or long-term, or both? You may need short-term finance to get up and running, with longer-term finance to keep you afloat through the first couple of years.

How risky is your business? A proven business idea might make attracting some types of funding easier. But there are options out there for innovative business concepts. Can you find out where your competitors get funding from?

What's your history with business/personal finance? An existing personal or business relationship with a lender or investor might make it easier to get money – as will a good track record in business and of paying back debts.

What will it cost and is it worth it? You can't get finance without it costing you or giving something up. You'll either pay interest to a lender or turn over a share of profits to an investor. How will those costs add up over time? Once you've figured out the cost, make sure it's worthwhile. Will the extra cash bring enough of an uplift in earnings or quality of life? In other words, what's the return on investment (ROI)?

Some funding fishhooks

Some business financing options might not be available to you. If you're fresh off the blocks, traditional lenders might be reluctant to take a chance on you. They can't see your past performance or judge your skill at running a business.

If you don't have any assets to put up as a security, it will be difficult to get a large loan. Don't give up though as there are a range of business funding options available and being clear on your needs will help you find the right match.

How Much Funding Do You Need?

Knowing how much money you need, and for how long, will help you choose the right type of finance to go for. Here are some tips to help you arrive at a number.

Business Budgeting Tips

It can be tricky figuring out how much money it takes to start, buy, run, or grow a business. Here are some things to think about as you go through the process.

Starting a Business

Building the business – list all the things it will take to get started. Include things like building fit-outs, vehicles, equipment, uniforms, initial inventory, website development and promotion.

Running the business in the early days – figure out what it will cost to pay leases, salaries/wages, suppliers and utilities from week to week. Your starting revenue isn't going to cover all this, so how much more cash will you need?

Sneaky costs – start-ups commonly forget to budget for things like permits, rental bonds, insurance, utility connections, bank fees, website hosting, marketing costs to boost initial sales and transport costs.

Wiggle room – things won't go as planned so put a buffer in your budget. You may need to hire staff if things take off, or costs may go up if a cheap supplier goes out of business.

Buying a Business

Get a valuation – A professional valuation will help you decide how much a business is worth, and it will tell you if expensive equipment is due to be replaced.

Check the books – Have an accountant look at the past two years of business accounts to make sure it will make you money. Budget for an initial dip in revenue as customers adjust to new management.

Work out the cost of change – Will you be re-branding, hiring staff, buying extra equipment, or trying new marketing ideas? Estimate the investment required.

Running a Business

What is a working capital loan? Day-to-day costs can be hard to cover if a big customer pays late, an unplanned bill comes in, or you have had a bad month of sales. Working capital loans keep things running while you recover.

How often will you need one? You may think you'll only need working capital loans at random times, but look for patterns. If it's regular and predictable, that may affect your finance strategy.

Avoid the high-interest trap – Working capital loans are often short-term and flexible, making them high-interest. If you need several of them, it will get expensive. Get an accountant to review your debt regularly. It might be worth converting some short-term debt to a lower interest, long-term loan.

Growing a Business

Make a budget – List all the costs involved in making the improvements, item by item and get an estimate for each. If you need to operate at diminished capacity while the changes are made, factor this in also.

The hidden costs of growth – Work out what will happen to your operating costs after expansion. You may need more inventory or staff. Check your budget covers this, or you can get a working capital loan.

Make sure it's worth it – Now you know the costs, figure out the return. Unless something's going to improve your profits or make business easier, it's probably not worth financing. Doing a cost-benefit analysis can help.

Consider your finance options – Could you finance it yourself if your vendors gave you longer to pay? Maybe you could negotiate a deal? Or vendors may be able to provide some finance of their own.

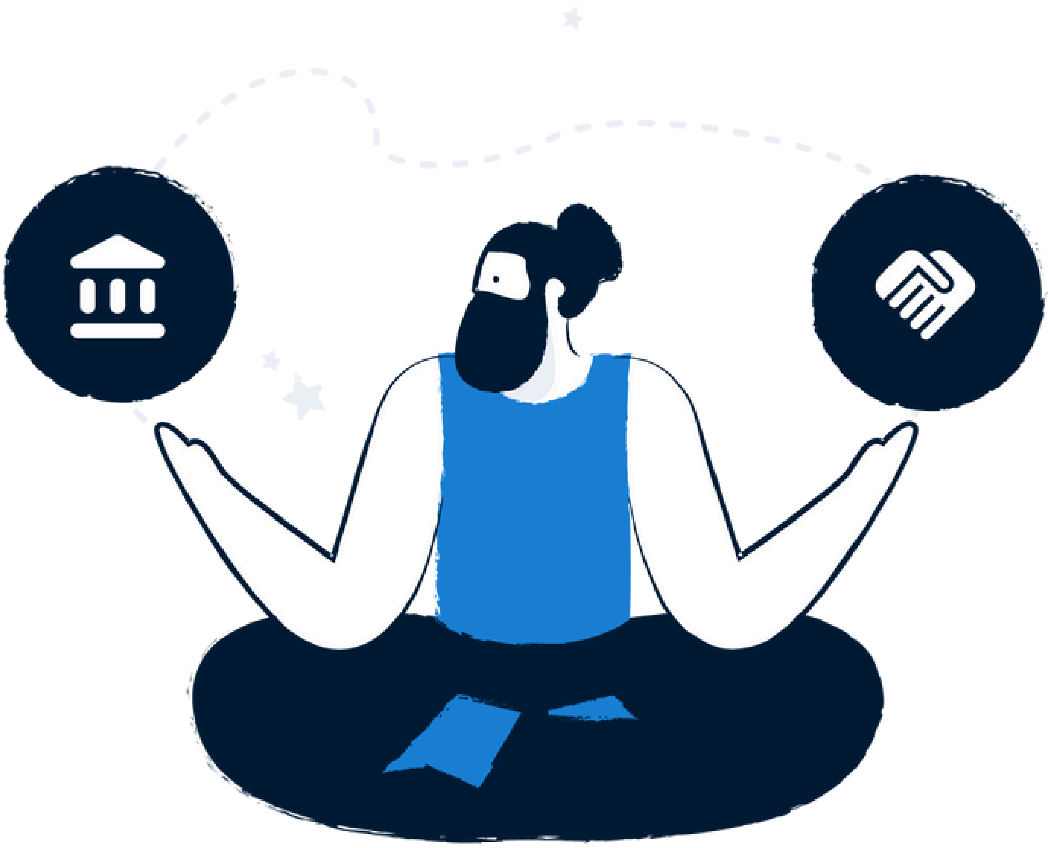
Think about cash flow – Remember that putting too much of your own cash into a purchase can backfire. If you run down all of your reserves, you may have to take a short-term loan later and they have higher interest rates.

Get an Accountant to Look at Your Numbers

Getting finance always comes at a cost. An oversight here, or a miscalculation there can have big implications. Taking on debt or allowing investors into your business is a big deal. It's great to run the numbers yourself but consult a professional before jumping in, as they're the experts at budgeting and finance.

Contact a Lawpath Business Expert Accountant today

Debt vs Equity Finance



Most forms of funding fall into one of two camps. You can get a loan or sell a share of your business to investors. Let's look at the main pros and cons of debt versus equity and understand how they can help or hinder your business.

Growing a Business

Debt is a loan that you must pay back. Equity finance is what you get when you sell a stake in your business to someone else.

Debt (Loans)		Equity Finance (Investors)
You're 100% in charge	**Ownership**	You give up some of the business
Use revenue to pay back loans	**Revenue**	Put revenue into growing the businesses
Harder to obtain if bad credit, no security	**Availability**	Support businesses most lenders avoid
Straightforward, not always fast	**App. Process**	Pitches require time and you'll need lawyers
Regular with fixed or variable amounts	**Repayments**	Dividends or returns are expected eventually
Other banking and credit service, insurance	**Extras**	Access to investor know-how and networks
Vary according to risk, can be unpredictable	**Interest Rates**	None
May have to mortgage your house to get large amounts of money	**Security**	Not required
You still owe the money or security	**If It Fails**	Investors loses their money
Lenders want to know you'll repay them	**Expectations**	Investors want to know you'll grow/make them money
No obligation once funding is repaid	**Exit Strategy**	Not the only owner, so getting out is complicated
Usually regular reporting obligations	**Reporting**	Provide reports to shareholders

Remember, this doesn't have to be an either/or choice. A combination of both debt and equity funding might be best for your business at times. But it pays to know what you're getting into with each.

The Finance You Choose Matters!

When you're desperately keen to buy, start or grow a business, you may feel like any finance will do. Don't fall into that trap. Choosing the wrong type of finance could break your business later. Each finance type has its own pros and cons so use this guide to learn about them and ask which suits your business, and you as a person.

Debt (Loans)	Other	Equity Finance (Investors)
Term loan A lump sum paid over time	**Grants** Funds that don't have to be repaid	**Equity crowdfunding** The public can invest in your business
Line of credit/credit card Available to use when needed	**Presales** Customers pay before an item is generally available for purchase	**Angel investors** Individuals who invest their own money
Peer-to-peer lending A crowdfunding loan		**Venture capital** Where investors are seeking high-risk/high-reward investments in start-ups
Friends & Family A lump sum paid over time		**Friends & Family** Those closest to you join your venture
Invoice Financing A lump sum paid over time		**Incubators and accelerators** Development schemes to build and boost small businesses

Begging, borrowing and bootstrapping

Some businesses don't require a lot of money or capital at the outset. Other businesses start out small, with minimal money, and build slowly. This is often called bootstrapping.

In these cases, it's common for owners to cobble together their own finance through personal savings, personal loans, or taking extra shifts at their day job.

Even if you're doing this, it's worth knowing about the types of finance out there. You may just need an extra injection of cash down the road to the business truly humming.

How to Get a Business Loan

Getting a business loan is still one of the most common ways to finance a business. So let's look at how they work, who's behind them and how to get one.

Types of Loans

Business loans tend to come in one of two basic forms:

- A term loan which is a lump sum you get all at once with a regular repayment schedule over a set period.
- A line of credit which is a pool of funds you can dip in and out of with flexible repayment amounts and interest charged only on the amount of money you use.

What are term loans?

Personal term loans, business term loans, start-up loans, business mortgages, asset loans, etc. are all types of term loans. These names denote the purpose of the loan, which may affect the amount you can borrow.

Where term loans vary is in the interest rates, charges, repayment terms and security required. Let's look at those options.

Interest rates and repayments

Fixed – You lock in one interest rate over the term of the loan. This can help with budgets and forecasting but you're likely to be charged an early repayment fee if you pay back the loan before the end of the fixed term.

Floating (variable) – The interest rate can go up or down. If it goes up, so do your repayments. But if it goes down, you can either reduce your repayments or leave them the same and pay off the loan faster. You can change the repayment out, pay off lump sums when desired and often pay the whole loan back early without penalties.

Security

Secured – if you can provide some type of asset or personal guarantee as security you may find it easier to borrow and get a larger amount. If you fail to make the repayments, the lender can take the security as their own.

Unsecured – a more expensive but less risky option, where you promise nothing as security. Interest rates and fees tend to be higher and it's hard to get if your credit history is poor. The amount you can borrow is generally lower.

It's worth noting that term loans are often used for long-term investments such as buying a business or large asset. They're also a good option for businesses with regular income because they can budget repayments and term loan interest rates are lower than line of credit rates. The longer you've been in business, the easier it usually is to get a term loan. Lenders like to see a successful track record.

What is a line of credit?

Revolving credit facilities, overdrafts, and credit cards are all a type of line of credit. They give you access to extra cash, but you're only charged interest on the portion of the money that you use.

Interest rates and repayments – you only pay interest on the amount used. You may have to pay a fee for having the facility. If you go over or you repay late, your interest rate may go up drastically or you'll have late payment fees added.

Security – can be secured or unsecured. Unsecured lines of credit tend to involve less cash and have higher interest rates.

Business lines of credit are often used for short-term finance as they can help you ride out seasonal lulls or cover unexpected costs.

Line of credit or business credit card?

A business credit card has the benefit of being useful for online purchases and ad-hoc expenses and keeping your business and personal spending separate. Some also offer an interest-free period, reward programmes, extended warranty insurance on purchase, and liability waiver insurance against misuse by other cardholders. As a bonus, they also allow you to track and categorise spending more easily.

However, they have higher interest rates and fees, and smaller credit limits than a line of credit, and they may require a personal guarantee which could affect your personal credit rating if payments are late. Protections and services may also be less than those offered with personal credit cards, so it pays to check with the provider.

How to apply for a loan

Take your time preparing important documents, make sure you complete everything they require, and follow the instructions carefully. To apply for a business loan, you will need:

Business plan – needs to explain the size of the opportunity and show how you'll take advantage of it. You should also show how the loan would be used.

Financials – provide a budget showing how you'll afford repayments. The budget should be realistic and based on sound assumptions.

Creditworthiness – banks want to see that you have a good record of paying bills and debts. They'll review your credit rating or credit score in business and possibly your personal life.

Security – If you want to borrow a lot, you'll be expected to offer something in return. If you provide some form of security, the risk is that the bank can take it if you stop making repayments.

Lenders aren't especially concerned if your business becomes the next big thing. They don't have shares in it. They love a steady, predictable yield. So you don't need a wow factor to apply for a loan, you just need to demonstrate that you're a solid bet.

Types of lenders

The main types of lenders:

- Traditional banks
- Online and alternative business lenders
- Peer-to-peer lenders

Traditional banks

Because of their size, traditional banks often have the best business loan interest rates. They can also package a range of financial services for you. They might combine a term loan and line of credit with deposit accounts and business insurance. Banks are more likely to approach a loan application if you have provided most of the funding yourself or provide solid security, have prior industry experience or business track records, or have a credible business plan. It can be hard to get big loans through banks, so before putting time into an application, speak with an accountant or bookkeeper to see if your application will have a chance.

Online and alternative business lenders

Many online lenders focus solely on finance – they don't provide other types of services. Some specialise in certain industry sectors. If you're a start-up business, have a less than shining credit history, or have no security, these lenders may be more approachable than banks.

They often focus on short-term and unsecured loans and frequently work faster than traditional banks. They accept online loan applications and may approve your loan within a day.

On the flip-side, their rates, fees, and terms may not be as competitive as traditional banks. That's how they manage the risk of offering unsecured loans.

Peer-to-peer lenders (P2P)

These lending platforms match people who want loans with people (or institutions) who are willing to fund them. This platform oversees the application process, repayments and if required, the security.

Applications and approval processes are online and often faster than banks. The loans are usually fixed-rate, short-term and smaller than those offered by traditional banks. Interest rates can also be lower.

What is the right type of lender for you?

Don't go to the first lender you see. Make a list of potential lenders and compare them on things like:

- Lending products offered (do they offer good term loans and credit deals?)
- Interest rates, fees and early repayment penalties
- Lending limits
- Ability and authority to make lending decisions quickly
- Friendliness toward small and/or local business
- What other services they offer that you might need (deposit accounts, international services, business insurance)

If your personal bank account is with a provider, consider approaching them. They can quickly see how you operate your personal accounts, and this may work in your favour – providing you've been a good customer. If you have a mortgage with the bank, they can see what equity is available for you to use as a security for business lending.

Talk to an accountant or business advisor about which lenders their clients have found to be supportive.

Friends and family loans

The bank of mum and dad has helped launch many businesses. It's often available when other types of finance aren't. You just need to take a few extra precautions.

How to borrow responsibly from family and friends

There's nothing wrong with starting a business with a family loan or one from a friend. No one knows you better. Plus, they'll often give you better, more flexible lending terms. There are some guidelines you should follow to prevent turning friends into courtroom litigants or being cut out of the will.

Pitch as you would to a bank or investor

- Keep it professional but friendly and show them why it's a good idea.
- Don't expect them to stump up every cent
- Be clear with them about how much you need and why
- Take them through your budget so they can see you intend to spend their money wisely
- Be open, transparent and manage their expectations
- Show them how and when you plan to repay them

Loan, investment or gift?

This can be one of the biggest misunderstandings when taking money from friends and families. Make sure all parties know what the situation is – especially other family members who might think you're about to blow their inheritance on a pipe dream.

Put it in writing

Create a formal record of the agreement. It will help you avoid misunderstandings at the outset, and it can be used to resolve disputes. For extra peace of mind, get a lawyer or accountant to review this.

If it's an investment, the agreement will be far more complex. The document will need to say how many shares the investor gets and whether they have a say in business decisions and also explain if they're going to be held responsible for business debts or lawsuits. Get a lawyer and accountant involved in writing one of these.

Always follow through

- Do what you said you'll do and give the lender a heads-up if things aren't going the way you hoped.
- Make your repayments on time. If they can see the money coming back to them,
- They won't begrudge it when they see you spending some money on yourself.
- Give them a report at the end of the year – how the business is doing, how much you've repaid and any obstacles you might be facing.
- Be professional and treat them with respect. A successful relationship with a lender can be good evidence to put in front of a professional lender further down the track.

Invoice Financing

Ever thought your cash flow would be better if everyone just paid what they owed you? You may not have to wait – you may be able to get an advance on your unpaid invoices.

An alternative to traditional loans

Businesses that are getting low on cash can take out a working capital loan, but many find it hard to go through the process of applying and waiting for approval. It could be faster and more flexible to use invoicing financing.

There are many forms of invoice financing, but the two most common are invoice factoring and invoice discounting.

What is invoice financing?

Instead of waiting on a customer to pay your invoices, you can take the invoices to a factoring company. Here's how it works.

- **Invoice your customers as usual**
- **Sell invoices to the finance company (the factor)**
- **The factor advances you around 80% of the value of the invoices**
- **Customers pay the factor when their invoice is due**
- **The factor sends you the remaining money, less their fees**

What is invoice discounting?

Invoice discounting is another way to generate instant cash from your invoices. But with discounting, you retain ownership of the invoices.

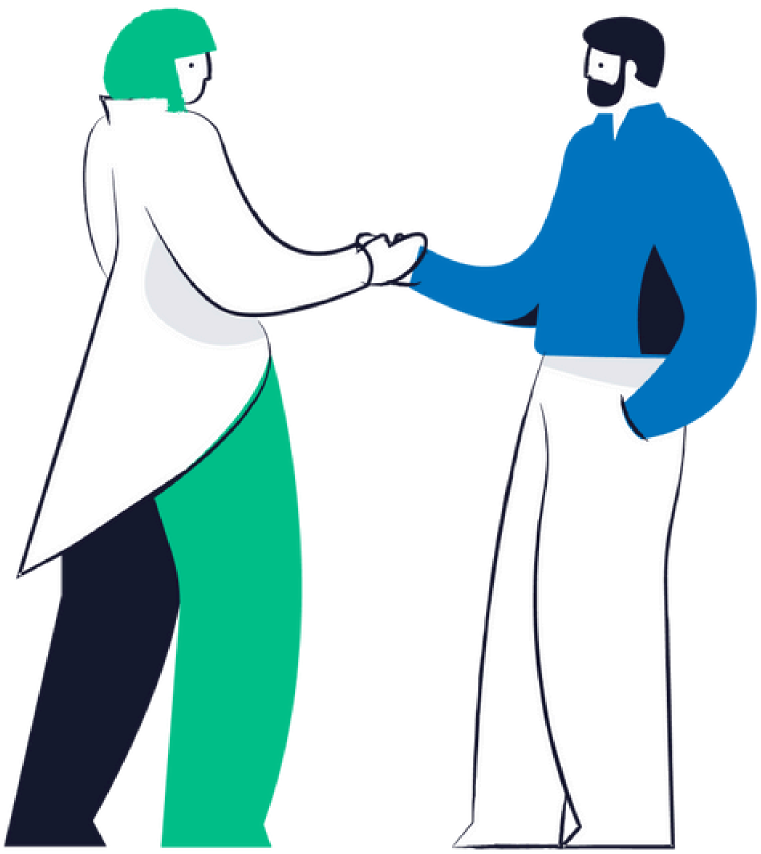
- **Invoice your customer as usual**
- **Send invoices to the finance company, who'll decide what percentage to lend**
- **The finance company advances funds as a line of credit or lump sum**
- **Customers pay you when their invoice is due**
- **You pay the finance company the amount advanced (or amount used from a line of credit) plus any fees or interest**

When selecting an invoice financing provider, ask what happens if the customer doesn't pay. In some cases, the finance company may take the hit. In others, it may fall to you.

What is cash flow financing?

This is like invoice financing but instead of selling invoices, the business gets a loan backed by its expected cash flow. This allows a business that's reliant on cash to get funds immediately to meet needs it wouldn't normally be able to afford.

How to Find Investors



Instead of going into debt, you could sell a part of your business to raise cash. This is called equity financing. Let's look at the types of investors, what they want from your business, and where to find them.

Types of Investors

Equity financing has become more popular in recent times, due largely to the growth in tech industries. Banks are less willing to take a risk on these types of start-ups, but private equity investors who can see the potential, put their money in, and are richly rewarded. It has given rise to a bigger investment community.

The easing of investment restrictions has opened opportunities for ordinary people to invest in a business. The main sources of equity financing are:

Angel investors – wealthy individuals who invest their own money in exchange for a share of the business and generally want to be involved in business decisions.

Equity crowdfunding – a platform where you can raise funds from the public in exchange for unlisted shares (equity) in the business. This is generally for consumer products or services and you'll do better if there's a wow factor to what your business is planning to do.

Venture capital (VC) firms – professional investment companies that invest their clients' money in exchange for a substantial share of the business.

Friends and family – those loved ones who support your dreams with their own money.

Business incubators and accelerators – development schemes to build and boost small businesses. Accelerators are more likely than incubators to have seed money to invest as they're focused on scaling a business that they see has potential, rather than innovation.

Are you ready for equity finance?

This isn't an option for every type of business. If you want to sell shares, you'll need to be a company (although you can sell an interest in a partnership). So you need to have the right business structure before you head down this route.

How big is the pie?

Having multiple shareholders might put off larger investors in the future. Think about how you want to structure any deal alongside the debt funding you already have or might take in the future.

Know your worth

Know the value of your business – get a professional business valuation done. Then you know what you're swapping or selling in exchange for funding.

Get advice

Before you commit to seeking funding this way, talk to a lawyer or accountant about the legal and financial implications of equity financing. Research and understand any current and upcoming regulations and laws you'll need to comply with.

Where to Find Equity Finance

You need to check what kind of legal markets you are in. Central and local government websites should have information about registered venture capital and crowdfunding platforms and any regulatory requirements.

Other places to check are:

Business incubators and accelerators – they may have seed money to invest or have access to angel investors.

Small business and industry associations – may have information about the equity funders their members have had success with.

Your accountant or bookkeeper – may have other clients who've been successful in getting funding. Or they may have clients looking to be angel investors.

What makes a good investor for your business?

While it may be tempting to emphatically agree to someone offering you money, stop yourself. Not all investors are created equal. Before you get yourself saddled with someone incompatible here are some qualities to look for. Ideally, they'll be:

- **Local** – so you have access to them, and they don't forget about you.
- **In your industry** – so you can draw on their experience, enthusiasm and contacts.
- **Connected** – so they can introduce you to the right people.
- **Committed** – so they're with you for the long haul.

The right investor can offer more than just their cash. They can share their experience and connect you with the right people to help your business grow.

What does an investor want to know about your business?

It helps to understand what makes an investor tick. When you know what they want from you, you can present a far more compelling pitch. They want:

- **Growth potential** – they want to back a business they think can take off or make big waves.
- **Involvement in the business** – they'll need assurance that you'll listen to and act on advice.
- **Personal investment** – if you're not prepared to put any of your money into the business why would they be attracted to invest?
- **Your exit plan** – let them know if you want to build the business quickly and flip it or if you're in it for the long haul.

How can you impress potential investors?

- **Show that you want to make money with them and for them** - not just take it from them.
- **What's your plan?** – show them a solid business plan and demonstrate sound financial thinking. They want to see that you can grow fast and have a plan for delivering the goods.
- **What's their plan?** – where do they see the business going and how involved do they want to be?
- **Be thorough** – take the time to prepare the necessary documents and complete everything they require. Send them your documents ahead of meetings so they have time to review them.
- **Check how you look online** – if your company has an online presence, be aware potential investors may look you up to find out more.

Generally, equity financing requires the preparation of disclosure documents. It is highly recommended that you seek professional assistance in preparing these documents as they must follow a range of regulatory requirements.

Small Business Grants

Grants are a great funding option for some small businesses. They can be a lot of work to apply for but if you get free money at the end, putting the time in could be worth it.

What is a small business grant?

A grant is money that's given to your business by the government, a company, or a philanthropist. Grants are essentially free money – you don't have to pay them back. Their aim is to give small businesses a helping hand and are often targeted at job creation, projects that traditional lenders don't support, and increasing economic benefits for communities.

Who gets them?

Competition for grants is high – everybody wants free financing, you'll see a lot of them are for non-profits, but keep looking, there are plenty of businesses too. Small business grants tend to be aimed at certain regions or sectors, specific types of businesses or causes, or community groups.

How big are grants and how do you find them?

Grants can go from as small as a few hundred dollars to as large as hundreds of thousands. Most, however, are less than 10k. For that reason, they're often a supplement to other types of small business funding. Grants can come from every level of government, philanthropists, or companies.

Here's what to check:

Government websites – central and local governments should have a list of their grants and links to other sources like non-profits, foundations and corporations. For more information, visit the Australian government page on grants.

Small businesses and industry associations - They may have their own grants or information about grants their members have had success with.

Your accountant or bookkeeper – they may have other clients who've been successful getting grants.

Are there start-up business grants?

There are grants for start-ups but they're not going to fund your whole business. They might cover the cost of getting professional advice to create a business or financial plan, specific training, or investment in equipment. They're aimed at getting your foot on the ladder – it's still up to you to climb.

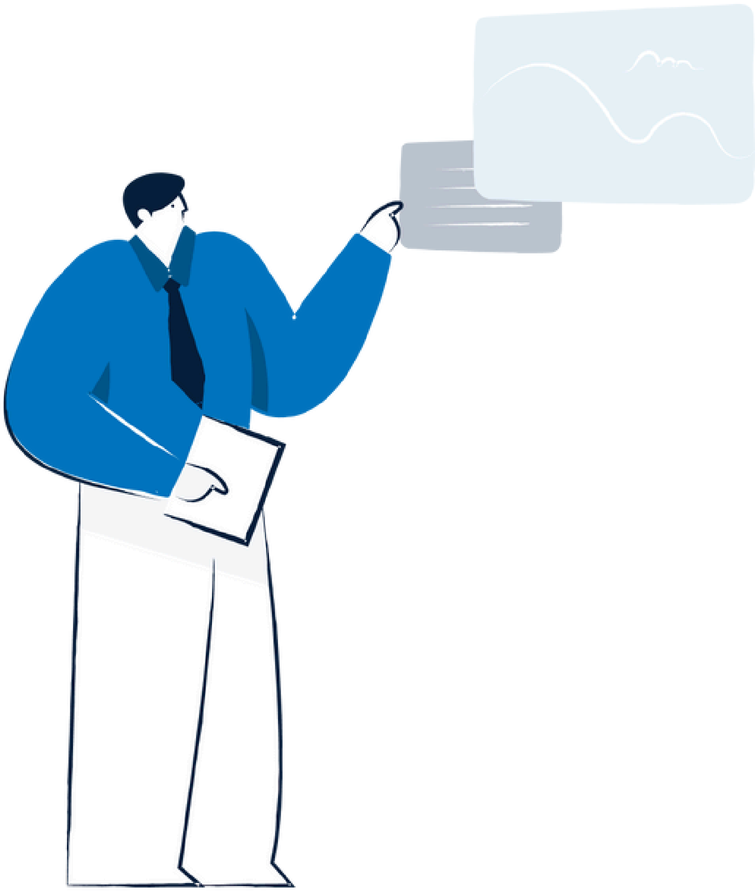
Grants for research and development (R&D) are more plentiful, especially for innovative products and processes. These grants can help you plan, develop, test and refine your idea. You'll need to find the final funds to go to market with your concept.

How to apply for a small business grant

The money might be free, but you'll need to show why you deserve it.

- **Don't rush it** – be prepared to put in some serious time on the application. So read up about what's required from you before you commit.
- **Tailor your application** – do your homework as to why the grant was created and its purpose. Your application should show how your business fits the aims of the grant and how the grant will help your business.
- **Be thorough** – expect to provide information on yourself as well as your product or service, your market demographics, and how you plan to spend the grant.

Pitching for Business Funding



Seeking business funding is a major step but you needn't be daunted. Here's how to help lenders and investors understand your business and decide whether to take the risk with you.

What to demonstrate in your pitch

Whether you're approaching a bank for a loan or trying to convince someone to invest in your business, there are some basics to get down.

Show you have a plan – the most important things to communicate are the opportunity, market analysis, how you'll resource the business, your business model, and financial forecasts and budgets.

Share detailed financials – show financiers you've thought of everything – the good, the bad and the ugly. Include allowances for unexpected costs, best and worst-case scenarios, a balance sheet, how the business is going to be profitable, assets and collateral.

Convince them you know your stuff – show you understand the industry you're entering but also give lenders and investors confidence that you understand the financial side of your proposal.

Get them excited - don't forget to show them your product or service. If it's not created yet, show them a mock-up. Make a video, take photos, show screenshots. Lenders and investors want to see something tangible. Don't leave it all to their imagination.