**Financing Your Business**

**We recommend that you contact the agencies in this Guide, who will be able to help you understand some of the issues surrounding the financing of your new business.**

**Cash Flow**

For the small and start-up business ‘Cash Flow is King’ – No cash - No business - it’s as simple as that!

In the early days of starting a new business many people concentrate on making profits. But profits are not much use if they are all tied-up in debtors, work-in-progress, or equipment. This particular difficulty is common to almost every type of business: manufacturers, contractors, retailers, even accountants and solicitors. Sometimes it is a seasonal problem, in other cases cash shortages are a constant problem.

The cash flow problem is relatively easy to recognise - you just have no cash. You may have lots of stock, efficient plant and equipment, large amounts of debtors, and even an excellent profit record, but if you do not have sufficient ready cash to pay your way you have a big problem. This problem cannot go unsolved for very long – so let’s look at how you can avoid this.

In creating your Business Plan you must list all the costs involved, and allow for unforeseen costs. Growing your business will eat money and, therefore, keeping a close eye on your expenses on an ongoing basis, and ensuring that debtors pay you on time is vitally important. Similarly, monitoring expenses, as a percentage of your turnover (total net sales), and comparing to the anticipated ratio in your Business Plan is well worth doing. This will keep your finger on the pulse of the business’ financial health. Many people focus too much merely on the turnover figure and take their eyes off the ball when it comes to expenses. Remember that broadly speaking:

**Turnover minus Expenses = Profit!**

**Financing Your Start Up**

You may never get a better analysis of your Business Plan than when you approach a bank, potential investor, or an agency about finance. If you need money to finance your start up, it will only be available if you can convince the lender that you can pay it back.

The hardest question to answer is what kind of capital should you seek? - Often we are not aware of options that are available to us, or don’t have the time to explore what is possible.

There are three main sources of money to fund your business idea: -

* Equity
* Debt
* Grants

**Equity**

Equity is the capital invested in the business by you, the owner, from your own resources. The advantage to the business of equity is that there is no interest charge and a return is only paid to the investors if the company is making a profit. There are two main sources of equity: -

* Funds from personal wealth
* Profits generated by the business after takeover

If you are contemplating using your own funds to finance your business start-up it would be wise to get advice as to the most tax efficient method of investing your hard-earned money. For example, if you invest your funds as Share Capital you can only ‘get it out of the company’ by selling the shares to an interested party, or by closing the company down and distributing the resultant funds to the shareholder(s). This might attract Capital Gains Tax (CGT). If, on the other hand, you give your business a loan, then this can be repaid to you tax-free.

It doesn’t make sense to use your savings ‘to pay yourself’ from your private bank or savings account as the enterprise gets under way and ‘save’ the company having to pay you in the early stages. Your business should always be charged a realistic wage for your efforts from the start. In the case where you have access to such funds you could lend the money to the company to pay yourself until such time as the business is in profit, and the loan can then be repaid.

Obtaining funds from family or friends can seem an easy and convenient way to fund your business, but there are a number of points to consider. For example, it is essential business practice to enter into a written agreement as to the precise terms on which such funds are sought and given. It is often too late some years after money has been given to the business and a problem has arisen, to recall the terms on which the funds were procured. Discussions as to what people ‘thought’ was agreed invariably end in an acrimonious confrontation and can ruin otherwise long-term friendly relationships.

When seeking funding it is important to realise that money alone is generally not sufficient. It is equally important that the investor understands the business, and brings other attributes to the table such as experience, customers and profitable contacts in the industry or other ‘door opening’ benefits.

Equity is free to the business on a day-to-day basis. If the business is in need of additional funds it may be an option to seek additional business partners, as an alternative to debt. Be careful though, because many business people make an early and costly mistake by ‘giving away’ equity stakes in their enterprise to secure start-up funding. If your business idea has real potential in the longer term, early equity disposal can eventually prove very costly for you.

If you are going to take equity partners, be sure that there is an agreement in place from the start so that the investor knows what they are getting, and how they are to get their investment back at a later date. One or two ‘reasonable’ sized investors are better than a number of small investors. Too many small shareholders can stymie further investment, perhaps from Venture Capital Funds, by creating too much investor ‘clutter’.

There are a number of Venture Capital Funds available to invest in business projects. Investments can range from as little as €50,000 to many m millions, depending on the ultimate potential of the business idea.

Venture Capital seeks out worthwhile projects in need of funds at a critical stage of the enterprise development. Venture Capital Funds generally want their money back over a shorter term than most other fund sources and, accordingly, impose strict conditions on their investment terms as to repayment time scale and equity stake.

When dealing with Venture Capital Funds, you must be conscious of the precise detail of any agreement entered into. Venture Capital Funds have a tendency to put increased pressure on non-performing enterprises that return looking for further investment. It is prudent when seeking Venture Capital Fund investment to be sure that you obtain adequate funds to deliver the expected results at the first attempt, otherwise you may find that you literally have bitten off more than you can chew, and any second bite leaves a lot less of the ultimate pie to be enjoyed by you.

Some agencies, such as Enterprise Ireland, have a panel of potential investors who have indicated their willingness to invest in worthwhile businesses. Most of the major accountancy firms and legal practices also have clients willing to take a financial plunge given the right opportunity. When contemplating such a course, you should attempt to secure the financial backing of someone who knows the nature of your business, and can bring more than just money to the table. It is essential that the investor also brings experience, input, customers, and ‘door opening’ abilities.

**Debt**

There are various types of debt. Some of these are general in nature, and some tailored to a particular purpose. Providers of debt finance like to see a reasonable financial investment contributed by the owners of the business. This is because: -

* They do not like to take all the risk
* Equity money is free
* In the case of insolvency, the debt is paid back before equity.

Lenders describe the relationship between debt and equity as the ‘debt to equity ratio’ or ‘gearing’. There are many different types of debt, some of which are listed below. Only some of these are likely to be relevant to your business: -

* **General:**
  + Term loans.
  + Overdrafts.
* **Business**:
  + Government Loan Guarantee Scheme.
  + Trade creditors.
  + Asset-linked
  + Invoice finance (for businesses that sell on credit).
  + Hire Purchases.
  + Commercial mortgages (for business property).
  + Plant and equipment finance.
  + Leasing (for vehicles or equipment)

**Grants**

Grants are generally only made available for encouraging investment in new business projects in certain circumstances, or in particular industries. If you are buying an existing business it is highly unlikely that you will be eligible for grants. However, if you think that your business could be eligible for such assistance you should contact one of the agencies in this Guide, who will point you in the right direction, including: -

* **Local Enterprise Office, Cork City** supports the start-up and development of local businesses with less than ten employees. Financial grants for eligible businesses may include feasibility study grants, business expansion grants, and employment grants. Other non-financial supports include advice, training, networking and mentoring. See [www.localenterprise.ie/corkcity](http://www.localenterprise.ie/corkcity) for details and eligibility.
* **Enterprise Ireland** provides financial and non-financial supports to companies in the manufacturing or internationally trading sectors with the potential to reach 10+ employees in the near future ([www.enterpriseireland.ie](http://www.enterpriseireland.ie/)).
* **Business Angels** are affluent individuals who provide start-up capital for businesses - in return for convertible debt or ownership equity ([www.hban.org/](http://www.hban.org/)).
* **The Seed Capital Tax Relief** and the **Business Expansion Scheme** give tax relief to investors who invest in qualifying companies.

The Seed Capital Scheme can be a very useful and convenient source of funds. Given that you are a compliant taxpayer, you can claim back tax already paid to the Revenue over a number of years. The scheme involves you making an investment in your company and you claim tax relief on this investment. All the conditions of the scheme must be satisfied for relief to be available. Broadly speaking 41% of your investment is the maximum that you can claim back under the scheme subject to a maximum investment of €600,000 e.g. if an individual invests €10,000 in a company €4,100 is the likely maximum that he/she will get back under the scheme. This scheme may be useful if you have been paying high tax and, more importantly, if you are in receipt of redundancy payments.

Successful applicants under the Seed Capital Scheme often progress to Business Expansion Scheme (BES) funding. Many BES applicants have found that the process is long and costly for the eventual return, while others have found their route to rapid and successful development through the BES scheme.

Full details of both the Seed Capital Scheme and the Business Expansion Scheme are available from the Revenue Commissioners.

**Web**: [www.revenue.ie](http://www.revenue.ie/)

The Local Enterprise Office, Cork City and Enterprise Ireland are two of the agencies that can qualify companies for the Seed Capital Scheme and the Business Expansion Scheme.

**The Banks**

A business loan from a bank is a very ‘clean’ way of financing your business. In most cases, having a good Business Plan is essential to convince the bank that you worth backing. Often, a bank will ask for personal guarantees or other forms of security. Remember that risk reduction is the name of their game, and it should be yours, too. Never offer security, especially if your Business Plan stacks up. Remember to shop around; there are many banks and even different branches of a bank that may have different lending criteria for new businesses.

**Dealing with Your Bank**

**Do:**

* Be prepared when meeting your bank. When dealing with your bank it is essential that you are adequately prepared, even from the first meeting. Make sure that you have a clear Business Plan and that you can answer any questions that your bank may have.
* Keep your bank informed in good times and bad times. If you inform your bank when things are going well, they are likely to be more understanding when things aren’t going so well. If you are facing problems don’t just ignore them. If you inform the bank of your problems they will be able to help you.
* Use your bank as a source of advice. It is important to gather as much information and advice as possible, as good advice is the key ingredient of any successful business.
* Choose a bank close to you. When dealing with your bank you want your business adviser to have knowledge of the market that you are selling to. By choosing a branch near your business location you will benefit from their expertise of the local market.
* Shop around before choosing a bank. Don’t choose the first bank you visit. All banks will have different financial products and offers so it is important to shop around and find out which bank has the best deal for your business. For example, some banks offer two-years free banking to start-up businesses.

**Don’t:**

* Be afraid to ask. Don’t assume that you may not be eligible for finance. It is always worth asking. For example, security is not always needed when applying for a loan.
* Make unnecessary trips to the branch. Take advantage of online and phone channels that your bank will offer. These will allow you to check your balance and make transactions without having to go to the branch.
* Forget to take advantage of cost saving facilities that your bank will offer. If you use online and electronic transfers you will save on transactions fees, stamp duty, postage and your own administration.
* Try to deceive your bank. It is important to be honest about your strengths and weaknesses as an entrepreneur as your bank will find out in the long run.
* Go over your authorised limits. You will have to pay a charge if you go above your authorised overdraft limit. If the limit on your current account is insufficient, discuss an increase with your business adviser.

**Credit Union**

Don’t forget your Credit Union. If you are not already a member of one, you should consider joining. You may well be able to borrow three or more times what you have in shares, over an agreed and extended period of time, even though the interest rate may be high.