SME finance

DRIVING LIFELONG PROSPERITY 2020

Finance for small and medium sized enterprises

Obtaining and securing SME finance can present a major challenge.

Accountants and other advisers are useful tools in not only making business owners aware of financing options, but also in ensuring that businesses are 'investment ready'.

BUSINESS PLANS

A solid business plan (management's pitch) is key to securing funding. The plan presents management's plans for the business in one concise and coherent document. The plan should:

- Set out a concise description of the business;
- Set out management's vision and goals for the business;
- Be capable of withstanding due diligence;
- Quantify how much funding is required for what and specifically when it is needed; and
- Detail how lenders will get their money back and/or investors will see a return.

A business plan provides a potential lender/investor with the critical information they need to know about a business and its objectives.

TYPES OF FINANCE

Finance types are broadly analysed as:

- Debt finance - banks/asset based lending companies;
- Equity (shares in the business) - business angels and private equity; and
- Grants (if available).

The type of finance sought should match the needs of a business. The overarching decision is between equity (shares in the business) or debt. In certain instances, the only option is equity, e.g. start up and knowledge based businesses where the lack of asset cover makes it difficult to access debt finance.

The lack of available profits/cash to fund repayments also restricts the availability of debt finance, particularly for growing and seasonal businesses.

DEBT FINANCE

Bank overdrafts and loans are the most common source of finance for SMEs, with facilities often being secured on business assets and/or by personal guarantees provided by owners. The main advantages and disadvantages (as compared to equity finance) are summarised below:

PROS

- Retain ownership (and control) of the business;
- Fixed repayments – easy to forecast cash impact; and
- Often cheaper than equity finance (tax relief on interest payments).

CONS

- Security requirement, often including personal guarantees;
- Locked into rigid repayment schedule; and
- Can be repayable on demand (if a business exceeds facility limits and/or breaches financial covenant).

EQUITY FINANCE

Equity finance involves the raising of capital in turn for an equity stake in the business. Investors often realise the majority of their return on sale/re-finance of the business, having seen the value of their stake grow. A clear exit / growth plan is therefore often required.

PROS

- Investors have a vested interest in the success of the business;
- Access to large sums of equity finance; follow up funding as a business grows; and
- Private Equity board representatives can bring a wealth of experience to a business.

CONS

- Dilution in owner's share of the business;
- Obtaining equity finance is often demanding, costly and time consuming; and
- Board influence – need to provide investor information.

The main providers of equity finance for SMEs are venture capitalists/private equity firms, business angels and friends and family.

BUSINESS ANGELS

- Individuals who make equity investments into high growth (often high risk) businesses.
- Typically invest £10,000 to £1,000,000, often as part of a syndicate.
- Mainly invest in businesses where they can add value, such as first-hand experience and network of contacts.
- Normally make decisions relatively quickly – no credit committee!

Before entering into any financial agreement, it is important to get advice. The role of the Corporate Finance adviser is vital, not only because of their experience in raising finance, but also because of their links with appropriate financial institutions.

VENTURE CAPITAL/PRIVATE EQUITY

- Invest in products or services with a unique selling point/competitive advantage.
- Do not normally invest in start ups, unless backed by a creditable management team with a proven track record.
- Often bring wealth of experience to a business, including operational improvements, business strategy etc.
- Typically invest £1m plus for the medium to long term: 3 to 5 years.

The Hazlewoods Corporate Finance team have completed numerous MBOs in a wide range of sectors. We offer hands-on partner support from initial planning to post deal support.

For further information, or to arrange a free initial meeting, please contact Paul Fussell.

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