Raising money for your business

The Law Society

Be prepared

Have you researched your markets and prepared a formal business plan?
If no…..
Prepare one - it is an essential pre-requisite to starting a business - write down your plans and set out some financial projections.

Has your business plan been checked by professionals?
If no ……
Do so. It reassures the bank and any external guarantors - and provides you with an all-important reality check.

Have you considered asset-based financing, eg leasing or factoring?
If no ……
Do so. There are often fewer long-term implications for your business.

Are you a sole trader or a partnership?
If yes …..
Take care! Liabilities will go all the way back to your personal wealth.
If no …..
Limited liability minimises the risks but a bank will insist on personal guarantees.

Have you checked your eligibility for a grant?
If no …..
Although small, and often difficult to apply for, a grant can be useful and may help postpone the need to borrow money. You may also be eligible for a grant for the fees of professional advisors such as accountants or consultants.

Do you seek an investor for money or also for skills and expertise?
If yes …..
Take care! Your investor may learn your business and set up in competition. A professional investor (eg a venture capitalist) will want a good return. If not satisfied, your business could be wound up to pay back the investment and interest.

Loan or shareholder

Do you want a bank loan?
If yes …..
You will need sufficient security or willing external guarantors. Take care! Check the value of your assets and make sure guarantors understand your plan.

Have you shopped around for the best deal?
If no …..
You should as banks and often their own branches vary their terms. Don't forget to use the internet to search for a good deal, as rates can be lower.

Can you be released from the guarantees as business assets increase?
If no …..
This is worth negotiating at the outset.

Is the guarantee limited to your share of the debt?
If no …..
Be clear and avoid 'joint and several' liability. Make sure there is a time limit too.

Is the guarantee secured, for instance on your home or by a debenture on the business assets?
If yes …..
Any joint owner or first mortgagee must agree. Take care! Secured guarantees are enforced and make sure you don't give too much security as you risk closing off other financing options.

Are you buying property?
If yes …..
You want a commercial mortgage - try building societies, smaller banks and the internet as sources of alternative finance.

Can you get a Government sponsored small business loan guarantee?
If yes …..
Make sure the bank loan officer understands it (some don't).

Do you want to sell a stake (shares) in your business?
If yes …..
Take care! Check you know your business's true worth; don't undervalue the shares.

Are you selling less than 25%?
If yes …..
Remember, any shareholder can act against the company if they object to its management.

Are you selling less than 50%?
If yes …..
You retain control but anyone with at least 25% can still block certain decisions.

Do you have a shareholders' agreement?
If no …..
Get one. It helps prevent costly disputes.

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Every business needs money in order to grow. Capital investment and plans for expansion can be exciting but taking on too large a commitment or one that is premature can seriously damage the health of the most profitable business.

You need to be sure that the business's viability is not threatened and that your personal wealth is not at risk. Also that any arrangement you enter into does not hamper your long-term plans, for example, to sell the business or pass it on to your family.

Extra cash is usually required because a business anticipates a temporary shortage before an investment generates enough profit to pay for itself. Therefore every means of improving existing cashflow - for example, faster billing, tighter credit control, streamlined systems - should be used to reduce the amount of new money required.

For all but the largest firms, the main ways of raising money are borrowing from a bank or other lender, and selling a stake

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in the business. You can also investigate asset-based finance, such as leasing capital items or factoring to borrow against your sales ledger. Often this is less restrictive than a loan but be careful to check the terms and overall financing cost.

Borrowing from a bank leaves you free to manage your business, but as security will be required, a small business without significant assets will have to put up the wealth of its directors (their houses), or of external guarantors, to pay back the loan if the business can't. Alternatively a 'debenture' - a floating charge on all the business assets - may be required. Don't forget that a bank overdraft is a very expensive way to borrow and you should avoid treating it as a long-term loan.

An investor can be an attractive source of finance because, unlike a bank, shareholders share the risks of the business and there are no interest payments. On the other hand any experienced shareholder, and especially a professional like a venture capitalist, will expect to see the value of their investment appreciate considerably. If it doesn't, they will want to interfere with the management, or sell up.

Loan, debenture and shareholder agreements are all complex legal documents with long term implications for the business and its owners and directors. Legal advice at an early stage is essential to negotiate the best possible terms and safeguard.

Checklist

- Do you really need a loan? Are your costs minimised and your credit control optimised? Have you looked at asset-based financing, eg leasing, factoring?
- Have you checked whether you are eligible for a grant (which doesn't need to be repaid or entitles you to improved terms, eg access to regeneration or training funds)?
- Have you considered the long-term implications of borrowing or selling shares?
- If you are a sole trader or partnership, are you prepared for all your personal assets to be put at risk if a loan cannot be repaid?
- Do your guarantors understand the risks?
- Have you prepared a detailed business plan, checked by your accountant and solicitor?
- Do you have sufficient unencumbered business assets, or free equity in your home, to secure a loan?
- Do you know the true worth of the business?
- Are you realistic about the intentions of your shareholders?
- Do you have shareholders' agreement?

Lawyers For Your Business (LFYB)

Lawyers For Your Business (LFYB) represents around 1,000 firms of solicitors in England and Wales which have come together to help ensure that all businesses, and especially the small to medium sized ones, get access to sound legal advice whenever they need it.

LFYB is managed and promoted by the Law Society and has been welcomed as a positive initiative by the Department for Business, Enterprise and Regulatory Reform, Chamber of Commerce, the Federation of Small Businesses and many other agencies and trade associations that are active in the small and medium sized business market.

We recognise that, for fear of running up large legal bills, a business will often not consult a solicitor until they have a serious problem. By then, of course, any remedy may be at its most expensive, if indeed one is still available.

In most cases businesses can save themselves money by seeing a solicitor for advice early on, especially where there is legislation to be complied with, or important legal documents such as contracts to be prepared. To remove the risk of incurring unexpectedly high legal costs LFYB members offer a free consultation, lasting at least half an hour, to diagnose the problem and any need for action, with full information, in advance, on the likely costs of proceeding.

How to gain your free half hour consultation

For a list of solicitors in your area who are Lawyers For Your Business members

call: 020 7405 9075
e-mail: lfyb@lawsociety.org.uk
visit: www.lawsociety.org.uk/lfyb

or write to us at:

Lawyers For Your Business
The Law Society
113 Chancery Lane
London
WC2A 1PL

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