



Financing your Business



Oifig Fiontair Áitiúil
Local Enterprise Office
Mhaigh Eo · Mayo

www.localenterprise.ie/mayo

How to Finance your Business

Getting enough of the right funding is one of the more difficult tasks that you will face as a new entrepreneur. Typically, start-ups draw on a number of sources to fund their operations, ranging from owners and external capital, grant aid and bank debit to credit from suppliers.

Types of Finance

There are basically only two types of finance:

- ▶ **Equity:** Capital invested in the business, usually not repayable until the business closes down or is sold
- ▶ **Debt:** Capital lent to the business, usually repayable at a specified date

Sometimes, it is possible to obtain grants or subsidies. Local Enterprise Office Mayo, for example, can provide support to certain types of business. You should note, though, that often there is a requirement to repay an element of these grants.

Equity

Typically, there are three types of external equity:

- ▶ **Seed capital:** Less than €125,000, for start-ups
- ▶ **Venture capital:** Between €125,000 and €600,000 for businesses at an early stage of development
- ▶ **Development capital:** €600,000+, for companies ready to expand

The first sources you should try are:

- ▶ **Family and Friends:** Depending on personal circumstances, this can be a fruitful source. But make sure they understand the risks involved and can afford to lose their investment. Put any agreement in writing
- ▶ **Business contacts:** It's worth checking to see whether someone you know will help you get started with a small investment
- ▶ **Business angels:** Professional investors who may take an active role in managing the business as well as providing finance
- ▶ **Other:** Crowdfunding, State Agencies, Enterprise Ireland, InterTrade Ireland, Local Development Companies, Horizon 2020

Debt

Owner's own debt is not a major source of finance for start-ups, since other investors prefer to see the owners' investment in the form of equity [more permanent than loans]. However, it may be appropriate for you to put some part of your investment in the business as a loan [and thus repayable].

Equity

If you are putting equity into your business, you must recognise that this investment will be exposed to the highest risk, because all other creditors rank ahead of you for payment in the event of a financial problem. Nonetheless, it is important for you to raise as much as you can from your own resources, since most financiers work on a "matching funds" basis – they will invest no more than you do.

Venture capitalists may also provide medium to long-term finance in return for an equity shareholding in unquoted companies. But VCs only invest in “growth” businesses, capable of showing significant returns on investment over a three to five year period.

While the Revenue Commissioners will not invest directly in a business, effectively they provide a source of equity capital through the Employment & Investment Incentive Scheme [EEI – previously the Business Expansion Scheme] – which is intended to help small businesses, established as limited companies, to obtain additional capital. The Start Up Refunds for Entrepreneurs [SURE], operated on a similar basis, allows founding entrepreneurs to invest in their businesses using refunds of PAYE tax previously paid.

Debt

Debt finance available to starts-ups includes:

- ▶ **Overdraft:** The simplest form of bank finance. Basically, this is no more than permission to have a minus balance on the business’ bank account. However, overdrafts must be cleared (and stay cleared for at least 30 days during the year, though not necessarily consecutive days) on an annual basis and the overdraft is repayable on demand
- ▶ **Term loan:** A loan for a fixed period, usually at a variable rate. Repayments include interest and capital
- ▶ **MicroFinance Ireland:** Your Local Enterprise Office can help with a MFI application (www.microfinanceireland.ie)
- ▶ **Long-term loans:** These provide businesses with capital for seven to ten years
- ▶ **Mortgages:** Loans to buy business property, secured on the property itself, with fixed or variable rate options

Types of Debt

Fixed debt is a loan that is secured on a specific asset – for example, on premises.

Floating debt is secured on assets that change regularly – for example, debtors.

Secured debt means that, in the event that the loan is not repaid, the lender can appoint a “receiver” to sell the asset on which the loan is secured in order to recover the amount due.

Thus, giving security for a loan is not something to be done lightly.

Other sources of debt include:

- ▶ **Family and friends:** Depending on circumstances, this can be a fruitful source. But make sure they understand the risks involved and can afford to lose their money. Put any deal in writing, with professional advice on both sides
- ▶ **Business contacts:** It’s worth looking to see whether someone you know will help you get started with a small loan
- ▶ **Banks:** The main source of start-up borrowing – all the major banks have special deals for start-ups. Access may be available to lower cost loans through the SCBI (www.sbci.gov.ie)

Leasing allows you to use fixed assets – for example, plant and machinery, cars, office equipment – with the minimum up-front cost. A regular monthly or quarterly payment is made, which is usually allowable for tax purposes. At the end of the lease, depending on the terms, you may have the option to continue using the asset for a modest continuing payment or to buy it outright from the lessor.

Initial Investment

Your initial investment must be sufficient to carry the business for a reasonable period before it reaches some kind of balance, when money coming in equals money going out. In addition to capital investment in plant, equipment and premises, your initial financing may have to supply most of the working capital you need until sales begin to generate sufficient income to give an adequate cash flow.

Your Initial Investment

The initial investment includes:

- ▶ Fixed assets: Property, renovations, fixtures and fittings, transport, machines and equipment, etc.
- ▶ Current assets: Stocks, debtors, etc.
- ▶ Cash
- ▶ Start-up expenses: Expenses paid before the business begins, promotion and opening costs, etc.
- ▶ Margin for unforeseen costs: There will always be something overlooked or that could not have been expected at the planning stage. Allow for it here.

Budgeting

Budgeting (also called “projections”) is the process of estimating costs in advance, in order to:

- ▶ Ensure adequate finance for the business to achieve what it has planned
- ▶ Provide a control mechanism over subsequent spending

The operating Budget forecasts:

- ▶ Turnover: Total sales
- ▶ Gross profit: The difference between the turnover and its purchase cost
- ▶ Overheads: All the expenses incurred in order to keep the business going
- ▶ Net profit: The gross profit less the overheads. Bear in mind that most businesses have busy times and not so busy times, and so turnover is not constant throughout the year. Budget for peaks and troughs.

Overheads

These are the expenses that you will incur in running your business, including:

- ▶ Staff
- ▶ Production overheads
- ▶ Premises
- ▶ Transport and travel expenses
- ▶ Selling and promotion
- ▶ General expenses
- ▶ Finance costs
- ▶ Depreciation



Your Cash Flow

The income generated by sales must provide sufficient cash flow to enable the business to cover all costs. If money comes in too slowly, the business can choke to death, even as demand booms. Cash flow – collecting money from customers as quickly as possible and getting the longest possible credit period from your suppliers. This is more important in the short term for a small business than profit, although a business must make a profit to survive.

Cash Flow

On paper, you could be the richest person in the world and yet not be able to buy a round of drinks, because you have no cash in your pocket. That is because there is a distinction between cash flow and profits. Cash is the lifeblood of a business and should be monitored rigorously.

More businesses fail because they run out of cash than from almost any other cause. Even profitable businesses can fail because of lack of cash!

Cash flow planning means looking at every item of income and expenditure in a budget and estimating when it will impact the business in cash terms. Look again at the Operating Budget:

- ▶ Which items of expenditure will occur every month?
- ▶ Are there any once-off payments such as legal fees, security deposit for rent, new phone lines, insurance, etc.?
- ▶ Any advance payments for suppliers, rent, etc.?
- ▶ Check your marketing plan. Are there seasonal patterns? Will some promotional actions increase sales in particular months? What are the exceptions of how sales will develop in the first few months? Does activity in a particular month mean extra expenditure for that month (advertising, direct mail, networking, meeting with mentor, holiday, travel, etc.)? Fill in those extra expenses.
- ▶ If clients have paid (or will pay) in advance, put that in the appropriate month

Financial Records

You must keep full and accurate records of your business sufficient to enable you to make a proper return of income for tax purposes. This is to allow for inspection of the documentation under the Companies Acts or tax legislation, for example, a VAT or PAYE inspection. It is important for you to be in a position to establish at any time:

- ▶ The business' takings
- ▶ All items of expenditure incurred, such as purchases, rent, lighting, heating, telephone, insurance, motor expenses, repairs, wages, etc.
- ▶ Any money introduced into the enterprise, and its source
- ▶ Any cash withdrawn from the business or any cheques drawn on the business bank account for the entrepreneur's own or their family's private use [drawings]
- ▶ Amounts owed to the business by customers, showing the total amount owed by each debtor
- ▶ Amounts owed by the business to suppliers, showing the total amount owed to each creditor
- ▶ Stocks and raw materials on hand

Accounting systems provide all this information [see diagrams below], as well as the information for the end-of-year accounts and to help you manage the business.

Financial Statements

The main financial statements included in a set of accounts are:

- ▶ Balance sheet
- ▶ Profit & loss account
- ▶ Cash flow

These statements are important. It is only by collectively analysing the balance sheet, the profit & loss account and the cash flow of a business that an overall impression can be gathered on the financial strength of the business.

Balance Sheet for 'ENTERPRISE PLC'

A balance sheet is a statement of a firm's assets, liabilities and owners' equity at a specific date (it is a "snapshot" of the business at a particular moment in time). When added together, the liabilities and owners' equity represent the sources of capital (where the money came from) and the assets represent the uses of the capital (how the money was spent); the two sides must always balance.

	€(000)	€(000)
Fixed Assets		250
Current Assets:		
CASH	50	
DEBTORS	75	
STOCK	25	
TOTAL CURRENT ASSETS	150	
LESS CURRENT LIABILITIES:		
OVERDRAFT	10	
CREDITORS	70	
TOTAL CURRENT LIABILITIES	80	
NET CURRENT ASSETS:		70
[=WORKING CAPITAL] [150-80]		
NET ASSETS		320
[=ASSETS EMPLOYED] [250+70]		
REPRESENTED BY:		
Long-Term Liabilities	100	
Share Capital	125	
Reserves	95	
Capital Employed [100+125+95]		320

Profit & Loss Account

The profit and loss account shows the revenue that the business has received over a given period of time, and the corresponding expenses which have been paid.

	€(000)	€(000)
Sales Revenue		250
Cost of Sales:		
Material	150	
Direct labour	100	
Production overheads	50	
		(300)

GROSS PROFIT		200
LESS SELLING EXPENSES	50	
LESS ADMINISTRATIVE EXPENSES	60	
		(110)
TRADING [OPERATING] PROFIT		90
ADD NON-OPERATING INCOME		5
PROFIT BEFORE INTEREST & TAX		95
LESS INTEREST EXPENSE		(15)
PROFIT BEFORE TAX [NET PROFIT]		80
LESS TAXATION		(30)
PROFIT AFTER TAX		50
LESS DIVIDENDS		(10)
RETAINED PROFIT		40

Cash Flow Projection for 'ENTERPRISE PLC' for 2016

	TOTAL €	JAN	FEB	MAR	APR
SALES REVENUE	5700	1800	1700	1500	700
OTHER REVENUE	1300	400	400	200	300
TOTAL CASH INFLOWS	7000	2200	2200	1700	1000
TOTAL CASH OUTFLOWS	6800	1400	1400	2400	1100
NET MONTHLY CASH FLOW	200	800	800	(700)	(100)
BANK BALANCE	600	1200	1200	700	600

Cash Flow

A cash flow statement shows the cash inflows and the cash outflows for a business over the past 12 months. A cash flow projection (or forecast) predicts the cash inflows and outflows for a business for a future period. When applying for loans or agency supports projections for 3 years ahead are required.

Training Available

Local Enterprise Office Mayo regularly delivers a training programme on "Essential Tax, VAT, Cash Flow & Debt Management" which is tailored to the needs of small business. The programme provides pragmatic financial advice and is highly recommended. For more information, please visit our website www.localenterprise.ie/mayo.





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