

Raising Finance with Harlands

An organisation is likely to want to raise additional finance at some point in its development, whether to ensure business survival or to fund growth.

When a company is growing rapidly, for example when contemplating investment in capital equipment or an acquisition, its current financial resources may be inadequate.

Few growing companies are able to finance their expansion plans from cash flow alone. They will therefore need to consider raising finance from other external sources. In addition, managers who are looking to buy-in to a business ("management buy-in" or "MBI") or buy-out (management buy-out" or "MBO") a business from its owners, may not have the resources to acquire the company. They will need to raise finance to achieve their objectives.

Our corporate finance team has a wealth of experience in helping organisations like yours to raise finance in the most cost effective and timely manner. We can assist your business to raise the most appropriate type of equity and debt finance, on the best market-tested terms.

Our extensive knowledge and contacts within the market enable us to tailor the funding for your specific requirements. We can advise on the most suitable structure for funding the following:

- Capital expenditure
- Sales growth
- Growth by acquisition
- Strengthening the capital base

Why would you need it?

- You are considering acquisition or expansion and will need additional funds to assist the development of the business
- You need to ensure survival.

There are a number of potential sources of finance to meet the needs of a growing business or to finance an MBI or MBO:

- Existing shareholders and directors funds
- Family and friends
- Business angels
- Clearing banks (overdrafts, short or medium term loans)
- Factoring and invoice discounting
- Hire purchase and leasing
- Merchant banks (medium to longer term loans)
- Venture capital
- Public sector funding authorities

A key consideration in choosing the source of new business finance is to strike a balance between equity and debt to ensure the funding structure suits the business.

The main differences between borrowed money (debt) and equity are that bankers request interest payments and capital repayments, and the borrowed money is usually secured on business assets or the personal assets of shareholders and/or directors. A bank also has the power to place a business into administration or bankruptcy if it defaults on debt interest or repayments or its prospects decline.

In contrast, equity investors take the risk of failure like other shareholders, whilst they will benefit through participation in increasing levels of profits and on the eventual sale of their stake. However in most

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circumstances venture capitalists will also require more complex investments (such as preference shares or loan stock) in addition to their equity stake.

The overall objective in raising finance for a company is to avoid exposing the business to excessive high borrowings, but without unnecessarily diluting the share capital. This will ensure that the financial risk of the company is kept at an optimal level.

Business Plan

Once a need to raise finance has been identified it is then necessary to prepare a business plan. If management intend to turn around a business or start a new phase of growth, a business plan is an important tool to articulate their ideas while convincing investors and other people to support it. The business plan should be updated regularly to assist in forward planning.

There are many potential contents of a business plan. The European Venture Capital Association suggest the following:

- Profiles of company founders directors and other key managers;
- Statistics relating to sales and markets;
- Names of potential customers and anticipated demand;
- Names of, information about and assessment of competitors;
- Financial information required to support specific projects (for example, major capital investment or new product development);
- Research and development information;
- Production process and sources of supply;
- Information on requirements for factory and plant;
- Magazine and newspaper articles about the business and industry;
- Regulations and laws that could affect the business product and process protection (patents, copyrights, trademarks).

The challenge for management in preparing a business plan is to communicate their ideas clearly and succinctly. The very process of researching and writing the business plan should help clarify ideas and identify gaps in management information about their business, competitors and the market.

Types of Finance – Introduction

A brief description of the key features of the main sources of business finance is provided below.

1. Venture Capital

Venture capital is a general term to describe a range of ordinary and preference shares where the investing institution acquires a share in the business. Venture capital is intended for higher risks such as start up situations and development capital for more mature investments. There are over 100 different venture capital funds in the UK and some have geographical or industry preferences. There are also certain large industrial companies which have funds available to invest in growing businesses and this 'corporate venturing' is an additional source of equity finance.

2. Grants and Soft Loans

Government, local authorities, local development agencies and the European Union are the major sources of grants and soft loans. Grants are normally made to facilitate the purchase of assets and either the generation of jobs or the training of employees. Soft loans are normally subsidised by a third party so that the terms of interest and security levels are less than the market rate. There are over 350 initiatives from the Department of Trade and Industry alone so it is a matter of identifying which sources will be appropriate in each case.

3. Invoice Discounting and Invoice Factoring

Finance can be raised against debts due from customers via invoice discounting or invoice factoring, thus improving cash flow. Debtors are used as the prime security for the lender and the borrower may obtain up to about 80 per cent of approved debts. In addition, a number of these sources of finance will now lend against stock and other assets and may be more suitable than bank lending. Invoice discounting is normally confidential (the customer is not aware that their payments are essentially insured) whereas factoring extends the simple discounting principle by also dealing with the administration of the sales ledger and debtor collection.

4. Hire Purchase and Leasing

Hire purchase agreements and leasing provide finance for the acquisition of specific assets such as cars, equipment and machinery involving a deposit and repayments over, typically, three to ten years.

5. Loans

Medium term loans (up to seven years) and long term loans (including commercial mortgages) are provided for specific purposes such as acquiring an asset, business or shares. The loan is normally secured on the asset or assets and the interest rate may be variable or fixed. The Small Firms Loan Guarantee Scheme can provide up to £250,000 of borrowing supported by a government guarantee where all other sources of finance have been exhausted.

6. Mezzanine Debt

This is a loan finance where there is little or no security left after the senior debt has been secured. To reflect the higher risk of mezzanine funds, the lender will charge a rate of interest of perhaps four to eight per cent over bank base rate, may take an option to acquire some equity and may require repayment over a shorter term.

7. Bank Overdraft

An overdraft is an agreed sum by which a customer can overdraw their current account. It is normally secured on current assets, repayable on demand and used for short term working capital fluctuations. The interest cost is normally variable and linked to bank base rate.

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Completing the finance-raising

Raising finance is often a complex process. Business management need to assess several alternatives and then negotiate terms which are acceptable to the finance provider. The main negotiating points are often as follows:

- Whether equity investors take a seat on the board
- Votes ascribed to equity investors
- Level of warranties and indemnities provided by the directors
- Financier's fees and costs
- Who bears costs of due diligence.

During the finance-raising process, accountants are often called to review the financial aspects of the plan. Their report may be formal or informal, an overview or an extensive review of the company's management information system, forecasting methods and their accuracy, review of latest management accounts including working capital, pension funding and employee contracts etc. This due diligence process is used to highlight any fundamental problems that may exist

To arrange a consultation call us on **0800 7831048**.