

## Financing your small business

One of the major reasons for the failure of small businesses is under-capitalisation, that is, starting-up or buying a business without enough money to make it work. In order to prevent this common mistake, it is necessary to carefully work out how much money you will need to start. A qualified accountant is an ideal person to help you to do this.

Consider the following questions about your finances:

1. Starting up a business involves many hidden expenses that arise just when you least expect them. Do you know how much it will cost to set up and run the business?
2. Have you worked out profit and loss and cash flow budgets for your first 12 months of business?
3. The lack of money to keep the business going is a common cause of failure. Have you worked out exactly how much money you are prepared to put into the business?
4. If you need to borrow money for your business, do you know where you will get it and how much it will cost you to borrow it?
5. Do you know if you will meet the requirements of the lender, for the money you need? Do you know what information the lender will ask for, and do you know how to prepare a loan application and a business plan?
6. Do you know what gross profit, level of expenses and net profit you can expect from your business?
7. Do you know what records you need to keep, to maintain control of your business?
8. Do you know how businesses pay tax (including provisional, company, capital gains, fringe benefits and goods and services taxes) and how you can best prepare yourself to provide for and pay future taxes?
9. There are several people who can help you to plan your finances. Have you discussed your plans with your business lender, accountant and solicitor?

### Borrowing money to set up a small business

Borrowing money to establish a small business is often a difficult task as they have poor record of failure and loss, making this type of loan risky for lenders.

As a general rule, you will need to have some equity in your business either by a direct cash investment or by providing some sound marketable security (such as a second mortgage on your house). Lenders will often make advances for setting up a small business but usually do not wish to be in the position of a joint venturer. They will usually need security for their loan, to enable them to recover their money, in the event that the business fails.

### Preparing to approach a business lender

Before approaching a lender, make sure that you have adequately prepared yourself. You will be required to have the following information with you:

- A **business plan** containing well-researched evidence that a market exists for your product or service. The basis for your estimated sales and evidence to confirm your major expense items. Realistic gross profit margin projections within industry standards.



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- A **statement of personal assets and liabilities** clearly identifying which of these are in your name exclusively and which are in joint names
- **Details of security available** to back the loan up if necessary and details of any debt secured by way of mortgage, bill of sale or other means. Lenders are reluctant to take third party security from family members, especially if those family members are at an age where there would be difficulty replacing the asset during their working life
- A clearly defined **repayment plan** that allows for interest rate rises during the period of the loan.

## Sources of Finance

- **Banks** – consider starting with your own bank. They can access your financial background and may already have security which may save you considerable establishment costs. Banks are the largest providers of business finance;
- **Building Societies and Credit Unions** are a source of finance though business lending is not usually their core business;
- **Finance companies** are active in business lending and can often structure a loan using a combination of long and short term lending (eg- term loan and a lease) similar to a bank;
- **Finance brokers** can assist you though you will normally need to pay them a fee to organise your finance. This needs to be considered in your budgeting though often this fee can be offset by savings (ie- interest rates and lender establishment costs) that you will make from accessing very competitive finance.

Please note that government departments do not lend or give grants to commence a business.

## Common Pitfalls

Take care to avoid some of the more frequent pitfalls:

- Don't borrow too little as under capitalisation is one of your high risk factors. Lenders are reluctant to allow you a second dip if you have to ask for more money. Often you may not have sufficient security cover to borrow more and from the lender's point of view, this indicates poor financial management.
- Underestimating the level of debtors is a frequent reason for under-capitalisation. Most small business starters haven't had much experience in credit management and either don't take debtors into consideration or have poor credit management skills. This often causes the level of debtors to climb above acceptable levels (ie- many account customers are slow to pay their accounts) and the business does not have enough cash to operate. You may wish to consider 'Factoring' or 'Invoice Discounting' to improve debtor payment.



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- When approaching a lender, presume that they know nothing about your business. You must present your case and convince them that the risk of lending to you is acceptable. Borrowers do not have a right to be given a loan. You may presume that you must convince them in one interview so take all the relevant information on the first visit.
- When you give security to a non-bank lender and later need that security for additional financing from a bank (eg- an overdraft facility), the bank may not be prepared to offer an unsecured loan and the non-bank lender may be unlikely to release the security.

## Further information

The following fact sheet provides further information on these issues:

- Business planning