

Funding Your Business

Smarter Business Guide to Finance

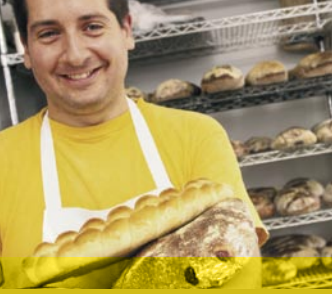


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Financing success

Getting the mix right

There are now an estimated 235,000 small and medium enterprises (SMEs) in Ireland. And based on the current trend this number is expected to rise to 275,000 by 2010.

Unfortunately, not all these new enterprises will make it beyond their fifth year in business. It is therefore vital that business owners are aware of the causes of business failure and know what steps to take to guarantee long-term success.

Having a sound idea, the right funding and a comprehensive business plan that is adhered to, are some of the key elements of business survival. However, in a dynamic marketplace it is also important to research your market thoroughly and keep up to date with the constant changes in your business environment, particularly in relation to customers, competitors and technology.

Ensuring the financial health of your business is also critical. Accurate indicators, financial statements, budgeting and good judgement based on knowledge and experience are the principal factors involved in successful financial monitoring.

To assess the performance of your business it is important that you understand financial statements, such as the balance sheet, profit and loss account and cashflow statement. Ratios and indicators can also be used to help interpret these statements. It is useful to compare these ratios with average values for similar businesses operating in your sector to get an accurate reflection on how your business is performing.

But regardless of whether the business is in start-up phase or is looking to expand, the availability of finance is one of the most important drivers of success.

There are multiple choices for businesses looking to raise finance. The type and amount of finance that can be raised will be determined by the creditworthiness of the business, the purpose for which the money is required, the risks associated with the business, the collateral available and other such factors.

Before approaching a bank, other forms of available finance should be investigated. For example, equity can come from the business owner, friends, family, business contacts or venture capitalists, who are willing to invest in your business. Also, Enterprise Ireland and County and City Enterprise Boards provide grants and financial support for the start-up and expansion of small businesses. Once a grant and/or equity has been organised, success is more likely when applying for additional funds from a bank.

For start-up businesses, there is a rough rule of thumb for finance. It suggests the optimum finance mix for getting a business off the ground is one-third equity, one-third grant funding and one-third bank finance. For established businesses, the level of debt will depend on the sector, and on the profitability and the working-capital requirement of the business.



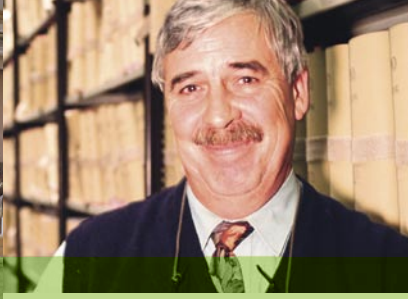
The cheapest funds you can find are within your own business. By focussing on key elements of your working capital, significant tranches of cash can be released. If you can collect money due from your debtors quicker, negotiate longer credit or an increased credit limit with your suppliers, or reduce your average stocking levels in proportion to sales, you will have to borrow less money to fund working capital. You will therefore save the cost of bank interest, or alternatively, you will have additional 'free' money to support additional sales growth. It is important to assess all capital expenditure carefully and don't finance capital expenditure from the business cashflow – use a suitable lending product. Control overhead and staffing costs tightly. Perform price comparisons. Prepare a cashflow forecast and have a cushion to cover unanticipated shortages.

When applying for bank finance you need to convince your bank that you are a good investment. Prepare yourself thoroughly before meeting with a lender and ensure that you have all relevant documentation available. A comprehensive business plan, including the financials of your business will be required. Have all external factors in the business environment, which may impact on your business, assessed and have plans in place to deal with these if required. You also have to convince your bank of your good character, management capability, and your capacity to repay the finance. Security may be required.

Banks can offer various forms of finance depending on your business needs, including short-term/working capital finance to facilitate day-to-day operations, medium-term loans, leasing and hire purchase, and long-term finance for fixed assets.

In choosing a financial institution, as well as considering fees and charges, interest rates, channel access, customer service, etc, it is also very important to consider the bank's knowledge of your industry and its reputation in the wider business community. As well as providing services and lending money, your bank can also offer advice on business-related issues, like what grants may be available. It can also provide practical solutions to financial issues and advice on making your banking more convenient and cheaper. Keep in touch with your bank and keep it informed about your business so it is well equipped to understand and respond to your needs.

Remember, there is finance out there waiting to be invested in your business, provided your proposition is sound, you prepare adequately and you present yourself properly. The key challenge then is for the business owner to utilise the finance for productive purposes and to earn a return sufficient to repay the funds, keep the business going and provide a profit.



Cashflow

Cash is king

Businesses need finance to grow and develop. While the availability of finance is only one of a number of key drivers for business success, it is, in all probability, the most important key success factor. Cash is the lifeblood of any business and business owner-managers have to keep it flowing. An added benefit is that the cheapest funds you can find particularly for financing expansion, are right within your own business. Good cash management aligned to strong business discipline will yield positive results and help crystallise tied-up cash. Sometimes there can be an inclination by business owners, particularly when things are going well, to overlook basic housekeeping issues particularly when it comes to keeping a eye on cash management. But by focusing on three or four key elements of your working capital significant tranches of cash can be released.

Debtors

Cashflow can be significantly enhanced if amounts owing to the business are collected faster. Every business needs to know:

- Who owes them money?
- How much is owed?
- How long it is owing?
- For what is it owed?

One of the greatest difficulties Irish business owners face is getting their customers to pay them. Slow payment has a crippling effect on business, in particular on small businesses who can least afford it. But there are a few simple actions that you can take to manage your debtors. If you don't manage your debtors, they will end up managing your business as you gradually lose control due to reduced cashflow and increased incidence of bad debt.

Ensure you:

- Establish credit practices as a matter of company policy
- Check out each customer thoroughly before you supply on credit. Use credit agencies, bank references, industry sources
- Establish credit limits for each customer and stick to them
- Continuously review the limits when you suspect tough times are coming or if in a volatile sector
- Consider charging penalties on overdue accounts
- Consider accepting credit cards/laser (debit) cards as a payment option, make it easy for your customers to pay you
- Don't let any one/small number of debtors get too big.



Debtors due over 90 days (unless within agreed credit terms) should generally demand immediate attention. Look for the warning signs of a future bad debt.

For example:

- Longer credit terms taken particularly for smaller orders
- The issuing of post-dated cheques by debtors who normally settle within agreed terms
- Evidence of switching to additional/different suppliers for the same goods
- New customers who are reluctant to give credit references
- Receiving part payment from debtors.

The act of collecting money is one which most people dislike for many reasons. There is nothing more important than getting paid for your product or service. A customer who does not pay is not a customer.

But when asking for your money, be hard on the issue, but soft on the person. Don't give your debtor any more reasons not to pay you.

Creditors

Creditors are a vital part of effective cash management and should be managed carefully to enhance the cash position. Purchasing is the start of the cash outflow and an over-zealous purchasing manager can create liquidity problems.

Consider the following:

- Who authorises purchasing in your company? Is it tightly managed or spread among a number of people?
- Do you know the cost to the company of carrying stock?
- Do you have alternative sources of supply? Ensure you are getting quotes from major suppliers and shop around for the best discounts, credit terms, reduced dependence on a single supplier
- How many of your suppliers have a return policy?
- Are you in a position to pass on cost increases quickly with price increases to your own customers?
- If a supplier of goods or services lets you down can you charge back the cost of the delay?
- Can you arrange (with confidence) to have delivery of supplies staggered or on a just-in-time basis?



There is an old adage in business that if you can buy well you can sell well. The management of your creditors is just as important as the management of your debtors. It is important that you look after your creditors. Slow payment by you may create ill feeling and can signal that your company is inefficient.

Fundamentally, the ability for a business to expand and grow is dictated by its ability to manage its cash effectively.

Stock

Managing stock is a juggling act. High levels of stock can place a heavy burden on the cash of a business. The key issue is to know how long does stock sit on your shelves before being sold. Remember that stock sitting on shelves for long periods of time represents money tied up which is not working for you. For better stock control measurements try the following:

- Know the number of times each major item of your stock turns in a year
- Sell off outdated or slow moving merchandise, it gets more difficult to sell the longer you keep it
- Consider having a part of your product outsourced to another manufacturer rather than make it yourself
- Review your security procedures to ensure that no stock 'is going out the back door'!
- Higher than necessary stock levels cost more in insurance, accommodation costs and interest charges.



The art of survival

10 reasons businesses fail

Nobody likes to think about failure. Business ventures are driven by people with a will to succeed. The very idea of failure is something that many banish from their minds altogether. Drive, ambition and the will to succeed alone, however, are seldom enough to guarantee success in an increasingly complex and competitive world.

Whether we like it or not, a significant proportion of new ventures in Ireland today won't make it to celebrate their fifth year in business. By taking a look at some of the reasons why businesses fail you can help your business to become vigilant to at least some of the more common pitfalls and causes of business failure.

1. A bad idea to begin with

While having faith in the initial business concept is an important attribute of any entrepreneur, it often isn't enough. It is sometimes the case that the 'unique' business idea is not so unique after all and that the market is already well served or there is less demand than you originally thought.

2. Bad planning

Your initial business plan is your blueprint for success. Failing to stick to the plan, failing to put in the kind of intense research needed to begin with or, more commonly, failing to seek out and

heed professional advice, are common ways in which a business can get off to a bad start. Planning ahead is vital at every stage of your business and should be under constant review.

3. Lack of capital

Under-capitalisation is a common cause of companies going under in the first few years of business. Adequate capitalisation must take into account a multitude of set-up and continuation expenses, not to mention putting food on your table. Many people start a business from scratch when there are established businesses for sale on the market.

Buying a pre-existing business can mean that you can bypass many of the initial hurdles, such as establishing premises, buying equipment and machinery and, of course, finding your first customers. While buying an existing business is no guarantee of success, it can give you an advantage during those crucial set-up months and can be a more cost-effective solution. Again, research and advice will help.

4. Not knowing the market

Knowing who your customers are and what they actually want, rather than what you believe they want, is one of the keys to business survival. Failure to keep in touch with your customers through implementation of a practical marketing plan and failing to keep up with their changing wants and needs is a recipe for disaster.



5. Cashflow or crisis management

When there is more money going out than coming in there's a problem. However, many businesses ignore (either wilfully or subconsciously) the underlying problem and manage each crisis as it (inevitably) comes along. Even profitable companies can sink due to bad cash management. Ignoring your cashflow situation often leads to spiralling problems.

6. Doing it all

The boss who drives her/himself into the ground is a more common cause of problems in a business than a neglectful one. Building a team of competent employees with set jobs and goals leaves you free to concentrate on essential issues. No job is more important to a business than effective management. A boss who is constantly doing the little things rarely has the time to concentrate on the bigger picture.

7. Inadequate control

While nobody expects you to do it all, it is essential to keep control of the business at every level and to have the right control mechanisms in place so that a potential problem can be nipped in the bud before it's too late. Extending too much credit or over-borrowing are common causes of failure. What's euphemistically called 'creative accounting', glossing over a growing problem or misrepresenting the actual position of a business, is no solution.

8. Inadequate protection

Bad things happen to good businesses every day. Whether it's flood or fire damage, loss of key personnel or theft, protection against risk can help secure your future.

9. Failing to change

No business exists in a bubble. Failing to take note of changes in the business environment can lead to problems. What your competitors are doing, changes in technology and best practices, as well as changing patterns in your customers buying patterns and tastes, need constant monitoring and adjustment. Doing this will allow your business cope with the rapid pace of change in today's business world.

10. Growing too fast

Fast, unchecked expansion can be more dangerous than slow growth for any business. Growing too rapidly brings with it the risk of loss of control and over-stretching of the business's resources and financial base.



Finance for business

Monitor your financial performance

When making decisions that will effect the running of your business it is vitally important to have at your disposal all relevant information that will help you make informed decisions. There are a number of financial indicators with which you should familiarise yourself with.

Cashflow forecasting

Firstly, it is important that you monitor the progress of your business against your business plan forecasts, this will help you measure your company's performance in respect to expectations. The cashflow forecast is an ideal but often under utilised means of making best estimates of your future cashflow. As you calculate the differences between budgeted and actual figures, problem areas will be highlighted and your financial performance monitored.

Forecasting is never an exact science, and the further you look into the future the less exact it will be. It is very likely that the figures in your 'budget' column will differ from those in the 'actual' column.

Typically the reasons for these discrepancies include:

- There are delays in debtors' payments
- The price of costs have increased, eg, labour, raw materials
- Sales don't match expectations; there may be various reasons for this, including changes regarding competition or economic conditions
- Governmental or European fiscal and monetary policy changing your business environment, for example, raising your taxes.



Financial statements

Financial statements are important as they provide a valuable insight into how a business is performing that you will not get from any other source — information you need as you monitor the health and growth of your business.

The three basic financial statements are:

- 1** **Balance sheet:** provides an overview of the current financial position of the business at the end of the year, comparing the Assets of the business to the Liabilities. The balance sheet also looks at where this money came from, i.e. the capital funding
- 2** **Profit and loss account:** The profit and loss looks at the position of the business over the year regarding the income coming into the business, and the expenses leaving. The profit and loss account is normally prepared at the end of the financial year thus giving an historical perspective of the figures
- 3** **Cashflow statement:** This is the 'actual' column in your cashflow forecast and serves to outline what happened to one of your most critical business assets — cash, in the past year. The cashflow statement shows how cash has been generated and consumed.

These three key financial statements are linked to give an overall picture of how the business is performing. In the immediate term the cashflow forecast/statement is a much more important day-to-day business financial performance monitor than the balance sheet or profit and loss account. As the latter two act on a historical basis, they will not show up the financial issues that you are immediately facing. A cashflow forecast can be prepared every month, thus giving you monthly updates on how your business is performing.

Financial indicators

Ratios enable you to interpret your financial statements — they give you a much clearer indication of what these financial statements are telling you about your business performance. The validity of everything you do with financial indicators depends on the nature and quality of your financial statements. So you must try to ensure they are as complete and as accurate as possible.



Making comparisons

Most of your analysis will be based on financial ratios or on data taken directly from the financial statements. While there are recommended values for some ratios and indicators, it may be most useful to compare them with averages or typical values for similar businesses.

Comparing the same ratios and indicators of similar successful businesses will help you evaluate your business more effectively. If your business has been operating for several years and this is your first time to chart ratios and other financial indicators, you'll need a series of balance sheet and income statements prepared at regular intervals.

For year-to-year comparisons, it's best if financial statements are prepared at the same time of year; preferably on the same day of the year. Look for trends over the period covered by the series. Improving trends indicate your business is doing well. Trends indicating deterioration are a clear warning of the need for change.

Profitability indicators

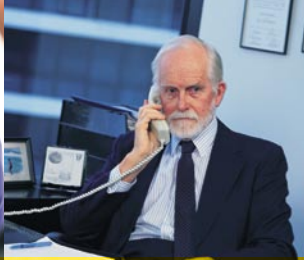
While you may know that you are doing well, what you really need to know is how profitable your business is.

Measuring performance

"How efficiently is my business operating?" is a question of concern to every proprietor. In most cases, efficiency and profitability are linked; efficient businesses usually are more profitable. Ratios and other indicators of efficiency often are called 'performance ratios' or 'performance indicators'. The key indicators you should be aware of are:

- Debtor Turnover Ratio
- The Debtor Collection Period
- Creditor Turnover Ratio
- Creditor Payment Period
- Stock Turnover Ratio.

No one indicator or financial statement tells the whole story. Based on experience, most owners and lenders use several indicators and financial statements that give useful insights into the health and performance of businesses. Accurate indicators, financial statements, budgeting and good judgement based on knowledge and experience are the principal basis for successful financial monitoring.



Applying for finance

Prepare for success

Banks and institutions that lend money have a store of knowledge about the success rate of small businesses. They will look at all the information available to decide whether they believe you are a good investment and will decide whether to lend you money on the balance of that appraisal.

You, the borrower, will provide part of this information. The bank will ask to see your business plan. The plan should give as much up-to-date information as possible about you and your business. You should include the following financial information with your business plan:

- 1 Audited accounts for the last three years (in the case of an existing business)**
- 2 Forecast trading profit and loss accounts for the next three years (if you are a new business)**
- 3 Cashflow forecast for the next three years**
- 4 Breakeven analysis**
- 5 12 months of business and/or personal bank statements**
- 6 Confirmation that your tax affairs are in order with the Revenue Commissioners, eg, PRSI.**

Potential lenders will also use their own credit files and outside sources. However, lenders will look past the surface numbers, to the intangibles of character, capacity, conditions, capital and collateral. By understanding each of these from the lender's viewpoint, you can anticipate your strong and weak points as they may appear to a potential lender.

1. Character

Character is about honesty, integrity and reliability. Specifically to a potential lender, character means that you will make every possible effort to repay the loan. You must be honest, a good manager and have a good reputation as perceived by the lender.

Therefore, it is important to be honest about your personal strengths and weaknesses. Past behaviour will be scrutinised. What is your credit history? Have you encountered personal and business problems in the past? Did you keep your word?

2. Capacity

Lenders look at whether your business will generate sufficient cashflow to repay a loan. They will take a detailed look into how the repayments will be financed. Lenders not only look at the company's financial forecasts, but also your ability to repay the loan if the business does not work out as planned. Do you have outside income (investments, a working spouse)? Do you have other skills that could produce income? Be prepared to provide solid answers to these questions and be able to offer real evidence.

3. Collateral

Security gives the financier a means of protection in case there are repayment difficulties. Secured means that, in the event that the loan is not repaid, the lender may 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. Selling the security will be a measure of last resort, and as the business is the main source of repayment, a bank will not accept any security if it doesn't believe your business is viable.



Loan collateral includes identifiable business and personal assets, such as your land and building, vehicles, and machinery. It is clear that due to the risk involved an individual would be ill advised to give a family home as security for a business loan. Seeking independent legal advice is advisable before providing security.

4. Conditions

Conditions are external factors impacting on your business that you cannot control but to which you must respond. They can be threats or opportunities such as technology, competition, regulation, and economic or social changes. The lender will look at the conditions, or trends, in the overall business economy, the trends in your community, the seasonal factors relating to your business, and the nature of your product or service. Another factor entering the decision-making process is how much competition there is in your market and how capable are you of competing in your market. Be prepared to tell the lender how you plan to deal with these conditions, how you have assessed the market and how your business will weather economic changes.

5. Capital

Capital is risk sharing. Equity capital measures how much the owners have risked in the company. Equity is a cushion to absorb losses. Debt capital must be repaid in good and bad times. The more debt a company has relative to equity, the riskier the loan. Most lenders will not put money into a new business unless they have concrete evidence that you have personally made a sizeable financial commitment to the

business. Also new businesses are generally a much higher risk for lenders. You should expect to invest a much higher percentage of the needed capital for your business if it is new.

Some questions to ask when applying for finance:

- What will the finance cost me exactly?
- Under what conditions is the financier able to call in the amount owing, and what would be the timescale exactly?
- Are there any penalties if I repay early?
- How are my other borrowings affected by taking out this new finance?
- What other services can you offer my business? For example, AIB offers an array of business products and services, from low interest credit cards to high interest bank accounts. Business guidance will also be available to you at your branch. While your local business relationship manager will also be an excellent source of information for you.

Prepare yourself

Prepare yourself thoroughly for any interview before initiating negotiations concerning business finance and make sure that all the available documentation is available to the lender. There is finance out there waiting to be invested in your business, provided your proposition is sound, you prepare adequately and you present yourself properly.



Choosing a bank

Choosing a financial partner is one of the key decisions that every business practitioner has to make. Your relationship with the bank is like any other relationship in that it requires mutual understanding and respect and the ability to engage each other in frank and candid discussions on business issues.

Before selecting your finance partner ask the following questions:

- Does the bank know my industry and my sector?
- What sort of a reputation does the bank enjoy within the wider business community?
- Will I have a dedicated relationship manager to act as a single point of contact?
- What type of channel access does my bank provide i.e. branch, phone, internet or all of these?
- Are the fees and charges competitive – are you only charged for the services that you use?
- Does my bank present ideas and views to reduce costs and improve services?
- Will my bank pay interest on credit balances in current accounts?
- Can my bank help me to recover and make trade-related payments efficiently and cost effectively?
- Is my bank a supporter of and participator in the industry led 'Switching Code'?
- If I am unhappy or disappointed with some aspect of the bank's service can I be sure that there is a proper customer complaint process where my view will be attended to promptly?

Did you know?

There are approximately 235,000 SMEs in Ireland and based on the current trend the number could rise to 275,000 by 2010.

Over 80,000 new businesses have been formed in Ireland since 1998.

Research indicates that about 1 in every 13 adults of working age are currently employed in every stage of entrepreneurial activity.

In a 2005 survey on entrepreneurs in Ireland, 66% of adults surveyed considered that starting a business represents a good career choice while 85% considered that there is a high degree of status associated with entrepreneurial endeavour.

Over 90% of Irish SMEs have credit lines with more than one bank.

Structured term lending of "5 years or over" is the single most popular category of lending to businesses, accounting for nearly 45% of all business lending.

Just 1 in every 2 Irish SMEs have a leasing agreement.

Business credit cards are used by only 20% of Irish SMEs.

By 2010 total business lending is forecast to exceed €100bn.

Price, familiarity with business and flexible terms are the top three factors when a business practitioner is choosing a loan.

Only one in every two working in the business community have pension planning in place for the future.

By 2010 there will be more new sectors and businesses that we have not even thought about.



Sources of finance

Assessing the options

It is important to fully assess the availability and the benefits of each source of finance. Many companies may even find that they have no need to go to a bank for an injection of capital as the necessary funds can be sourced elsewhere.

Below we examine some of the potential sources of finance available to business owners.

Sources of funds

1. Self, family, friends, shareholders, directors (loans and equity)

Equity: One way to raise funds for a business is for the business owner to invest money in it or to receive finance from private individuals (friends, family, business contacts, venture capitalists, etc) in exchange for stakes in the company (equity). It has no cost other than spreading the ownership, and possibly control, over more parties. If outside investment is being considered, a written agreement should be drawn up with the help of professional advice. Banks generally like to see business promoters investing their own money in their business. It shows their commitment to the business and reduces the overall level of bank debt needed to kick-start the business and to facilitate future growth.

Venture capital fund: If a business or business idea is in need of a cash injection to fund expansion, product development or acquisition, then a venture capital fund may be the solution. It provides money for investment in innovative enterprises in exchange for a stake in the enterprise. The expertise and advice of the venture capitalists is also at the disposal of the business. Venture capital investments are usually for a period of 3-5 years at which stage there is normally an IPO, a merger, an acquisition or a buy-out.

2. Internal company sources (retained profits, stocks, debtors and creditors)

The cheapest cash you can find is right in your own business. This is covered in the earlier section on cashflow starting on page 4.

3. Mergers and acquisitions

Corporate finance services can offer expert advice on areas such as initial public offerings (IPOs), mergers and acquisitions, corporate broking and private-equity finance raising.



4. State support

Enterprise Ireland is an Irish State development agency and one of its main areas of focus is on driving regional enterprise. Through an extensive network of 13 Irish offices and 33 international offices, it works with its clients to assist them to compete and grow. It also works closely with local industry bodies, third-level institutions and other business networks to encourage and promote start-ups, spin-off enterprises and business expansions. It continues to co-invest with the private sector in the development of venture capital funding and it now operates four venture capital funds that have specific regional mandates.

County and City Enterprise Boards are also involved in developing small businesses. In 2005, the 35 County and City Enterprise Boards had the capacity to provide up to €16,700,000 in financial assistance to support the start-up and expansion of small local businesses employing up to 10 people.

They offer:

- Capital grants of up to €75,000
- Redeemable preference share investments of up to €75,000
- Employment grants of up to €7,500 per additional employee in certain circumstances
- Feasibility study grants for market research or prototype development
- Advice, information, training and mentoring services.

Overall, about one-third of the aid provided by County Enterprise Boards is repayable. Where the aid is provided on a repayable basis though, it is usually on very generous terms with zero or very normal interest/dividends, 12 months moratoriums and 4-5 year repayment/redemption terms commonly available.

Business Expansion Scheme and Seed

Capital Scheme: these schemes are designed to aid small and medium sized enterprises to grow. They are a vital source of seed capital, which is the life blood of start-up companies.

The Business Expansion Scheme (BES) has been in operation since 1984 and will continue until 31 December, 2006. The scheme gives income tax relief to those who invest capital in qualifying Irish companies thus enhancing the ability of companies to attract outside investment. The tax relief is given for the year in which the investment is made.



The Seed Capital Scheme forms part of the BES – the scope of the BES has widened to provide a refund of tax already paid by an individual who sets up and takes employment in a new qualifying business. The relief is known as the Seed Capital Scheme and will continue until 31 December, 2006.

5. Business banks

Banks serving businesses offer a wide range of short, medium and long-term finance products and services. Getting bank finance is essentially a selling exercise – the concept of the business idea needs to be sold to the bank. Banks will assess the level of risk of the proposal and need to satisfy themselves that the potential rewards match the risk – ultimately, does the proposed business venture have the capacity to repay the debt?

Assessing levels of debt

The Current Ratio, which is a measure of liquidity, is important if you're thinking of borrowing money as it indicates the ability of a business to meet its current debts. You should have more Current Assets than Current Liabilities. A ratio of 2:1 is a good guideline. However, it depends on the nature of the business.

Current Ratio = Current Assets/Current Liabilities (Current Assets include any assets that can be turned into cash within 12 months. Current Liabilities are liabilities due within 12 months).

The Debt Equity Ratio looks at business debt levels by measuring the relationship between the capital invested by owners and investors and the capital provided by creditors. A low ratio generally means that the business is financially stable and is likely to be in a good position for applying for finance. A high ratio indicates a greater risk to a current or future creditor, as the business is largely being financed by debt.

However, a very low ratio may indicate that the business is too conservative in the utilisation of available debt. This ratio generally should not be greater than 1:1.

Debt Equity Ratio = Total Borrowing/Total Capital (Total Borrowing is total long-term and short-term debt from the balance sheet. Total Capital includes shareholders funds, ordinary and preference shares and other share issues, which are found in the balance sheet).



Practical tips when applying for bank finance

- 1** Ensure that you have all relevant information available when applying for credit facilities. The normal items required will be your business plan with up to date audited accounts and cash-flow projections. It is also beneficial to have an up to date listing of stock, debtors and creditors
- 2** Ensure that the bank's security requirements are complied with as quickly as possible
- 3** If an overdraft is sought, ensure that it will be adequate for the year. This will eliminate time-consuming requests for increased facilities during the year
- 4** Ensure that your account operates within its authorised overdraft limit. If, due to unforeseen circumstances, your current limit is not sufficient, discuss an increase with your branch in advance of requiring the funds. This eliminates surcharge interest and saves a 'referral' administrative charge levied if your account operates in excess of its authorised limit
- 5** Electronic banking allows you to view details of your bank accounts and transfer funds if required
- 6** The more of your business you give your bank, the easier it is for the lender to price your 'package' rather than by item
- 7** Keep an eye out for special deals offered by banks
- 8** Use a company Visa card to cover employee's expenses.

Other guidelines and hints in working with a bank

- If you are approaching a bank for the first time consider using references
- Invite your relationship manager from your bank to your premises to help them understand your business
- Submit regular and quality information to your branch
- Be honest and open. Keep your relationship manager advised of developments and advise them of bad news before it actually happens
- Use your relationship manager as a source of information and as an introduction to other businesses and people who can assist you
- Keep within the terms of credit agreements and keep your personal finances in order
- Use bank brochures, literature and websites to obtain information.



Types of bank finance

Short-term/working capital finance

This includes basic business banking facilities and financing options that facilitate the day-to-day operations of a business.

Business overdraft

Every business needs access to cash over and above its natural cashflow from time to time. A business overdraft gives businesses the flexibility to manage short-term cashflow needs without having to arrange a new credit facility every time.

Business credit line

This can be used to separate core working capital of a seasonal nature from day-to-day requirements, at a competitive rate of interest, below the standard overdraft rate.

Business credit cards

These allow business expenses to be separated from personal expenses, while facilitating business transactions made by phone and the internet. They are a flexible and convenient short-term means of obtaining cash, paying bills and making purchases.

Invoice discounting

This can help a business overcome cashflow problems caused by funds tied up in debtors, giving immediate access to up to 80% of invoiced debt without affecting relationships with customers.

Factoring

This can be used to bring a one-off improvement to cash flow. It involves selling business debts, at a

discount, to the factoring company on a continuing basis in order to obtain immediate cash payments in place of the expected future payments.

Bill payment facilities

There are short-term loan facilities that allow a business to spread the payment of once-off, annual expenditure, such as tax, rates, audit or subscription fees, over a period of up to twelve months at fixed and competitive interest rates, giving the business greater freedom to plan for the future.

Insurance premium finance

This is the perfect way to spread the cost of businesses insurance premiums over the year, freeing up essential working capital.

Medium-term finance

This is finance usually repayable in up to seven years, and is usually needed to pay for plant and equipment, but it may also be used as working capital. There is a range of medium-term finance facilities that can offer maximum choice and flexibility. These include term loans and leasing and hire purchase, which are viable alternatives to taking out a business loan if a business needs new equipment or vehicles.

Term loans

A business loan offers funding tailored from a range of options to suit every stage in the set-up and growth of a business.

Leasing

This is a finance facility that enables a business to use an asset over a fixed time period, for regular payments.



Contract hire

This differs from finance leases in that the lessor is responsible for maintenance and, if necessary, replacement of the asset.

Hire purchase

Similar to leasing, hire purchase allows you to make use of equipment/vehicles while still paying for them, but in a hire purchase agreement you take ownership of the item with the last payment of the agreement. The asset itself is the security for the finance borrowed to buy it.

Long-term finance

Long-term finance is normally associated with the need for fixed assets such as property, manufacturing plant and equipment and assets, which will be used in the business for several years. In certain situations a case may also be made for the use of long-term finance as a practical alternative, when short-term financing requirements recur on a regular basis. The most common long-term types of finance are:

Bank loans

A fixed asset loan can allow a business to buy plant or machinery and pay for them over the period of their useful life, up to ten years. Flexible terms may be agreed upon. For example, options of postponing capital repayment for up to two years where appropriate.

A business mortgage

This is designed to provide a long-term, flexible finance package to enable the purchase of premises, the refinance of an existing property or the purchase an investment property.

Sale and lease back

This involves an agreement between a firm and an institution, wherein the firm sells its property, or large item of equipment, to the institution, and at the same time takes out a long-term lease on it from the institution. It releases more cash for more profitable investment elsewhere but reduces the security in the business.

In the current Irish market there are clearly multiple choices for the business owner looking to raise finance. The type and amount of finance that can be raised will be determined by the creditworthiness of the business, the purpose for which the money is required, the risks associated with the business and the collateral available.

The key challenge for the borrower is to utilise third-party finance for productive purposes and to earn a return on the funds that are at least sufficient to repay the lender and provide some return to the business for taking the risk.

With interest rates at their lowest level in over thirty years, borrowers need to be mindful of the potential impact of a sudden or unexpected rise in interest rates. Even a 0.5% rise in rate could increase your interest bill by 10%. As with all financial transactions, care should be taken and professional advice sought before committing to using various forms of finance.

Keep in regular contact with your bank so that they are well equipped to understand your needs. As well as assisting with credit facilities, your bank can offer advice on business-related issues and provide innovative and practical solutions to financial issues affecting businesses.



Maximising your bank

Building relationships

The key to getting the best out of your bank is to take an active role in establishing a good relationship with your bank. As with all relationships, the key is communication. You need to create trust and build understanding between you and the bank manager.

Your relationship with your bank manager is about more than lending money and providing you with services. The bank will be able to offer general guidance, other relevant information, such as what grants you may be eligible for, and useful insight into your local business community.

Keep your bank manager informed, send your bank manager copies of your accounts at regular intervals and invite him/her to your business premises. Being able to see how your business works and how the money is flowing in and out will give him/her a deeper insight to your business.

By keeping your bank manager informed about business challenges and successes, you are more likely to receive an understanding and educated response when you need help. During times of difficulty your bank manager's dispassionate advice can often be invaluable. Leaving things to the last minute, though, when your back is against the wall, signifies a lack of judgement and poor management control. Moreover, it significantly reduces your options and those of the bank manager.

Optimise banking facilities

The effective use of electronic services is key to cost effective banking. Banks offers a wide range of services to commercial customers which make routine banking more convenient as well as decreasing the cost of carrying out your banking business. Some of the banking services, which can be profitably utilised for the advantage of your business include:

Your bank accounts

It is recommended you have two bank accounts for your business. A current account is ideal for day-to-day business transactions. A separate deposit account is suitable for short-term money management. This account will also earn you interest.

PayPath

This allows you to pay your employees directly into their bank accounts. This cuts out a large amount of paperwork and expense. All you have to do each week or month is supply payment details on tape, on disk or through a direct dial service.

Direct debits

These enable you to collect regular payments directly.

Creditor payment

This is a method of electronic payment of creditors. It allows you to give details of the payments you want to make and the bank will do the rest. There are no cheques for you to issue and there is no chance of you missing payments.

Business credit cards

Credit cards can form a streamlined and cost effective means of monitoring business expenses. They reduce the need for cash floats and enable



you to set the most appropriate monthly credit limit per employee. Business credit cards have special rates based on actual volumes of spending.

International banking services

Banks offer expertise in effecting international electronic payments, currency accounts and cash management products.

Cash management services

Such services for commercial and corporate customers allow you to view details of your bank accounts, transfer funds, make payments and get information on the financial markets.

Nightsafes

This is a facility to deposit your daily takings outside normal banking hours.

How to minimise fees and charges

1. Notes lodged

The standard rate for notes lodged is 45 cent per €100 lodged. If you are able to improve the quality and presentation of the lodgement it may be possible to qualify for discounts on the standard rate.

2. Notes withdrawn

The charge for notes withdrawn is 45 cent per €100. This charge could be avoided by:

- **Computerising staff wages and salaries, rather than writing cheques or paying by cash**
- **Using a company Visa card to cover employees' expenses**
- **Using automated payment systems like direct debits or standing orders as much as possible.**

3. Credit cards

A credit card processing facility could help to reduce the cash and cheque elements of your lodgements. There is also an associated reduction in security risk derived from lower cash holdings.

4. Cheques

Avoid unnecessary charges for unpaid cheques by ensuring all cheques processed are drawn correctly, eg:

- **Ensure amount in figures agrees with amount in words**
- **Ensure cheques are signed**
- **Ensure cheques are not post-dated or out of date**
- **Ensure cheques are drawn in accordance with cheque guarantee card regulations**
- **Ensure that cheque stubs are filled out properly and retain copies of account statements to avoid ordering duplicates**
- **Give the bank a mandate to process lodgements deposited via the night safe facility to save you on possible charges.**

5. Authorised limits

Ensure that your account operates within the authorised limit and if, due to unforeseen circumstances, your present limit is insufficient, discuss an increased facility with your manager in advance. This benefits you by eliminating surcharge interest, and also saves you paying a referral charge of €4.50, which is levied if your account operates in excess of its overdraft limit.

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