What Small Business Banking Customers Want

Information on banking relationships and support for SMEs

Expert knowledge means success

Contents

Note: This publication has not been updated since it was last published. Some of the hyperlinks may have changed and may need updating. In addition, some of the information in this publication may be out of date.

Introduction

Most business owners and managers recognise the importance of establishing and maintaining relationships with their professional advisors - accountants, solicitors and brokers – and see them as "part of their strategy team". The relationships with these advisors usually last for several years. Sadly, the same cannot often be said of the relationship held with bankers – ever-increasing account charges and penalty interest plus perceived demands for more and more security coupled with reducing service standards have created much tension between business owners and their bank.

Small businesses are important bank customers

But the fact is that banks are in the business of lending money and having a strong relationship with a banker is important, especially for growing businesses. Loans to small business owners constitute a significant, if not the largest, part of most bank lending today. Most bankers want to work with their small business customers and will go to great lengths in helping them work through their problems. A good relationship between a business owner and a banker enables small problems to be identified early and enables them to be tackled before they get out of control.

Improving relationships with customers

The British Bankers' Association[1] (referred in this publication as BBA) announced on 4 May 2001, the new Statement of Principles covering how banks will work with SMEs who borrow from their bank.

The revised Statement of Principles sets out best practice for both banks and businesses, emphasising the need for a shared approach; getting the relationship right at the outset and keeping the lines of communication open if things start to go wrong for the business.

Specific attention has focused on the appointment of investigating accountants as Administrative Receivers. When considering a rescue proposition, banks will not only use their own advisers, but will also take into account independent advice provided to the business owner. Banks will also appoint an alternative receiver if directors have genuine concerns that the recommendations of investigating accountants are not sufficiently independent.

Copies of the Statement of Principles will be provided to all new businesses when they open an account with one of the subscribing banks. The Principles came into effect on 1 June 2001.

What angers customers?

Banks should take note of the following customer issues:

- Being kept on hold for excessive lengths of time, while being told repeatedly how much the bank values their custom.
- Battling bureaucracy to resolve a problem. Staff should be empowered to tackle complaints immediately.
- Rude or over-friendly staff - both extremes can make customers feel uncomfortable.
- Anonymous staff who refuse to give their names.
- Broken promises - businesses should not make promises to customers which they cannot honour.
- Lack of customer-friendly complaints handling systems - if it is difficult to complain, most people will not bother. They will simply take their business elsewhere.
- Premium rate advice lines. It would be better customer service to provide freephone or lo-call numbers.
- No human voices on the telephone - mechanised systems will fail to connect to which take customers through a lengthy process only to deliver them back to the beginning.

Top Ten Tips for good customer service

Banks should follow the following advice to improve their customer service:

- Talk to your customers - carry out surveys. Ask customers what they want and make it easy for them to give you feedback.
- Listen to your customers - listen to complaints and compliments. Don't be defensive – accept criticisms as they will highlight areas for improvement. Let customers know if you are acting on their suggestions.
- Build trust Keep your promises. Deliver when you say you will. If things go wrong put them right quickly.

The Banks' Treatment of SMEs

In March 2002, the long-delayed response to a Competition Commission investigation was published. The Government found that a "complex monopoly" had seen small and medium sized enterprises (SMEs) overcharged by their banks – the Competition Commission report showed that Royal Bank of Scotland, Barclays, Lloyds TSB and HSBC have been overcharging small business customers and had formed a monopoly.

A raft of proposals have been suggested to foster greater competition - the Government has told the four banks they must offer small businesses either free banking for business transactions or pay them interest on their current accounts.

- Take complaints seriously – don't be dismissive or patronising. Have a customer friendly system for dealing with complaints so that if things go wrong, staff are easily accessible to put things right.
- Get it right first time - it saves you time and money if customers are handled well from the outset.
- Make the most of your staff - invest in training. Value them. Empower them to deal quickly with complaints. This will build morale and happy staff lead to happy customers.
- Go the extra mile - a willingness to delight customers is what separates the best from the rest.
- Do not make assumptions – your last customer service survey (last years) is probably out of date now - keep talking to your customers. The most successful companies know they cannot afford to rest on their laurels and are always willing to try something new and learn from others.
- Learn from your mistakes - and put them right.
- Put yourself in your customer's shoes - would you be delighted by the service you receive? Would you do business with you?

Business Banking Code

On 7 March 2002, the British Banking Association (BBA) launched the 'Business Banking Code', ahead of the highly anticipated Government report into the small business banking services. This Business Banking Code was updated on 31 March 2008.

The codes are reviewed every three years after consultation with consumer groups, HM Treasury, the Financial Services Authority, the Office of Fair Trading and other interested parties and contain:

- an enhanced promise by banks and building societies to treat customers fairly and reasonably
- a new commitment on responsible lending;
- more help for customers who may be heading towards financial difficulties;
- strengthened credit assessment practices to enhance responsible lending;
- prohibition of account closure as a result of a customer making a valid complaint;
- clearer information about products, including pre-sale summary boxes for unsecured loans and savings accounts;
- information on how to find your lost account (dormant account);
- greater clarity of cheque clearance times; and
- clearer information about credit cards and credit card cheques.

The Business Banking Code is a voluntary code sponsored by the British Bankers' Association (BBA), the Building Societies Association (BSA) and APACS - the UK payments association - which set the standards of good banking practice for banks and building societies to follow when they are dealing with personal customers in the UK. For more information see our publication *IP301 – Business Banking Code*.

Building a good relationship with your Bank

As with all relationships communication is vital. You need to build trust and understanding between you and the bank manager. Talking to your bank manager shouldn't be terrifying - they just have a job to do like the rest of us.

Try to understand the bank's point of view. Banks are just like you, they are in business to make money. They do this by providing services for which they charge, and by lending money on which you pay interest. If they don't do this, they don't make money. So if your bank manager turns down your loan application, it may be because they perceive a flaw in your proposal, or do not have enough confidence that you would be able to meet the repayments. It is important to realise that it is very unlikely to be in a bank's best interest to see a business go to the wall.

Invite the bank manager around to your business premises. Show them round and introduce them to everyone. Give them a feel for how you work together as a team. It is also good because you tend to be more relaxed in your own terrain.

Sweeter relationships with bank managers?

A guide, entitled *Get your bank manager to say 'YES'!*, has been published by the Forum for Private Business (FPB) in response to mounting concerns over the banks' lending to smaller firms. FPB report that almost 80% of their members recently reported that the terms and conditions of bank lending have got worse over the past year.

The issue hit the headlines after Government enterprise czar and Apprentice star Lord Alan Sugar claimed some small business owners had only themselves to blame for their inability to access finance. Lord Sugar said he understood the banks' reluctance to lend to many smaller firms and put much of the problem down to inflated expectations created by easy access to credit over the past decade. The FPB took issue with many aspects of Lord Sugar's views and believes thousands of viable, well-managed SMEs are unfairly being denied loans.

The new FPB guide is intended to help address this problem and give small businesses the best possible chances of securing a loan. Outlining seven golden rules for securing a bank loan, the guide is co-written by three expert figures. Electronic copies of the guide will be available free of charge to small businesses through the FPB's website. It is the first in a series of authoritative BusinessBuilder guides which the FPB is producing in order to help smaller firms to prosper. This new guide is available only on completion of a form on the FPB website at: www.fpb.org/page/698/Bank_manager_report.htm

Keep your bank informed on a regular basis. Banks don't like surprises and customers who fail to keep their bank informed of changes are viewed guardedly. One way of keeping your bank informed is to send them copies of your monthly management accounts. Being able to see how your finances 'work' will help them understand more about your business. Ask your bank manager what they would like to see.

When things go wrong keep your bank informed. Please don't put off telling your bank manager in the hope it will all go away. Phone them straightaway and ask for a meeting. Clarify why you want the meeting. Be truthful about any difficulties you are facing and explain that you want to talk about the best way of sorting things out.

Address any problems early. If you can address problems early and head-on, you can often prevent, or find solutions to them. Your bank manager's unbiased advice at this point can be very useful.

Outline the whole story. The bank manager's experience will help them to suggest how you could overcome any difficulties. For example, it could be that late payers are proving a problem for you. In this case, give your bank manager an 'aged analysis' of your debtors and creditors, showing what is due for payment now and what is a month or two months overdue.

How to resolve any complaints or problems you may have with your Bank

This is a general guideline outlining how to effectively resolve any complaints with your bank, and if necessary dealing with the banking ombudsman, and going to court.

While banks try to provide an error-free service, mistakes and problems can happen. As a customer, you should be aware that banks have steps in place to help you resolve any complaints or problems you have – ask your bank for more information. Some general guidelines have been outlined on the following page.

Table of general guidelines

Steps	Action/Commentary
Step 1:	The first thing you should do is contact the bank which sold you the product or provided the service. Try to talk to the person who originally dealt with you. If you phone to make your complaint it is always advisable to make sure you note the name of the person you spoke to, and the date and time you called. Keep this in a safe place as it is a record of your complaint. You will often have to follow up any phone calls with a letter. Your letter needs to be clear, simple, and include essential information. Try not to be sarcastic or abusive as you are less likely to get a good result. They may immediately agree you have a valid complaint. Or they may be able to clear up any misunderstanding. If the bank is no longer trading contact the Financial Services Authority (web: http://www.fsa.gov.uk) or call their customer helpline on (0845) 606 1234 for advice on what to do next.
Step 2:	If your situation has not been resolved to your satisfaction, you should take the complaint higher within the bank. Ask for details of the bank's formal complaints procedure. If they do not give you this information, or you're not happy with how they are dealing with your problem, take the case to the chief executive, or whoever is the most senior person in the bank. It is usually better to make your complaint in writing. You could also send a copy of the letter to the 'compliance officer'. This is someone employed by the bank to make sure it keeps to the law and other rules.
Step 3:	If your situation still has not been resolved, you can take your complaint to the banking ombudsman, or take your case to court. Banking Ombudsman The Office of Banking Ombudsman (OBO) is an independent office that investigates complaints from individuals and small businesses about banking services. This service is free of charge. If you are a sole trader or partnership you are eligible to use the Ombudsman Scheme. If you run a limited company, the company must have had a turnover of less than £1m in the previous year to be eligible to use the service. Before you contact the OBO, you must first try to resolve your complaint directly with your bank. You must have reached the stage where the bank sends you a final response, stating that they cannot reach agreement with you. This is sometimes called a 'letter of deadlock'. You can make your complaint to the Financial Ombudsman Service (http://www.financial-ombudsman.org.uk) which is bringing together eight separate complaints-handling and ombudsman schemes, including the banking ombudsman, into one. This will provide a simple and informal service for resolving disputes. The banking ombudsman will look at the specific details of your case, if necessary ask for extra evidence, decide whether your complaint is justified, and if justified order the bank to put things right. If necessary, the OBO can order the bank to pay you financial compensation. Commercial lending decisions, such as whether a bank decides to lend or withdraw support, are outside his terms of reference, unless there is evidence of maladministration. Going to court If you are not satisfied with the way a bank has responded to your complaint, you can take your case to court. However, in most cases, using the OBO is quicker and cheaper. It is advisable to use the small claims court if you can, as going to other courts can be a long and expensive process. If the amount you are claiming is not more than £5,000 you can normally use the small claims court. This is less formal than other courts and you do not need to use a solicitor or barrister.

What are you looking for from business banking?

It's important to work out what exactly you are looking for from a bank.

Please print out this table and rate the following attributes on a scale of 1 -10, where 1 is very unimportant and 10 is very important to you when sourcing the ideal bank to meet your banking needs.

You can plot your scores for each bank you visit. This will give you the opportunity to compare how closely each bank is likely to meet your individual banking needs, after you have evaluated each bank's service provision.

The key is to select the bank which matches your needs closest by checking the scores you gave for how you felt each bank was likely to perform against each service element. To do this, look at each bank and how closely the ratings you gave them for each service attribute meets your importance ratings.

For example, if you rated the bank with a higher score on any service element than your importance rating, the bank is likely to *exceed* your expectations in meeting this service attribute. Reversely, if the rating you gave the bank's service element is lower than your importance rating, the bank is not likely to meet your expectations.

Table 1: Your expectations

Ratings	1	2	3	4	5	6	7	8	9	10	Bank 1	Bank 2	Bank 3	Bank 4
Knows my business														
Knows the industry														
Knows the market														
Offers advice														
Range of services														
Availability of credit														
Competitiveness of interest rates														
Competitive charges														
Realistic collateral														
Tailors finance														
Deals with one person														
Access to loan officer														
Speed of decision														
Efficiency														
Reliability														
Friendly staff														
Convenient location														
Convenient hours														

Comparison tables for small business banking customers

Small businesses are able to compare the accounts on offer from a wide variety of different banks through a free service launched on 31 May 2001 by the British Bankers' Association. Businesses can view account comparison tables tailored to their own particular circumstances, together with a full breakdown of the features of any account listed, including latest details of charges and interest. There is even a breakdown of all business accounts that provide introductory offers.

The service, Business Account Finder, is available at http://bba.moneyfacts.co.uk and enables any small business, club, society, or charity to gather a wealth of information from one central resource by providing:

- The facility to build tailored account comparison tables that suit your particular circumstances
- The option to view a full breakdown of any account listed, including the latest account charges, interest rates payable, borrowing rates and services that are available with the account
- A breakdown of all business accounts that provide introductory offers
- The facility to compare the full details of two accounts side-by-side

Business Account Finder is a joint venture between the BBA and Moneyfacts Group and is updated immediately on the BBA website when details change.

Applying for finance from your Bank

Banks offer a number of borrowing schemes, each tailored to suit the varying needs of business. You will need to carefully examine the charging structure, terms and conditions that surround any offer.

If you are in any doubt about any of the terms and conditions, ask your accountant or other business advisors for their opinions.

It is a good idea to let your bank manager see your business plan before you meet up, as this will give him or her time to consider your plan in more detail.

A bank may be willing to improve its offer if you have other quotes. Your negotiations are more likely to succeed if you have a good credit score, or have built a good bank relationship.

Questions to ask the Bank

Ask the bank to confirm the terms and conditions of the loan in writing, and carefully analyse them before you sign any agreement. These details should include:

- The amount you are borrowing;
- The interest rate you will be charged;
- Details of other charges the bank propose to make;
- How and when you should make the repayments;
- Any security required;
- Any arrangement fee to cover the costs of setting-up the facility and finalising the security arrangements;
- When the loan will be reviewed;
- What sort of circumstances will trigger an early review or repayment; and
- The minimum information needs to be provided when the banking facility is reviewed.

It is also recommended to ask the following questions when you borrow from your bank:

- How much in total will the finance cost me?
- Are there any penalties if I repay the finance early?
- How are my other finance packages affected?
- Could you transfer money between my accounts without asking me?
- Under what conditions would you be able to call in the finance?
- How long will it take to obtain this finance?

Questions the Bank is likely to ask

The kind of questions the bank is likely to ask when you borrow from them includes questions about character, ability, margin, purpose, amount, repayment, and insurance. Plan carefully and consider the kind of information and forecasts that your bank will want to see, emphasise the underlying business and the people running it.

Bank lending decisions are made around the CAMPARI model. The following questions may help you understand the type of questions your bank might ask:

Character	• Is the customer trustworthy with a good credit history?
Ability	• Are they actually capable of achieving what the business plan proposes? • Has any market research been carried out? • How good is the product? • Do they have the necessary experience?
Margin	• How risky is the proposal, and what interest rate would reflect this risk?
Purpose	• What is the purpose of the loan, and its relevance to the business? • Does the demand for the product or service justify the investment? • Is the type of finance being requested, for example overdraft, loan, or a package of financial services suitable?
Amount	• Does the amount seem too little or too much? • How much is the proprietor putting in himself? • How have they worked out the amount asked for?
Repayment	• Is the business able to generate enough money to repay the loan and interest?
Insurance	• Is there a contingency plan for repaying if things don't work out as expected? • Can the business owners provide any security against the loan in case things don't work out?

Interest rates and security

Banks will set the interest for your borrowing when they have looked at factors such as:

- Their overall evaluation of the risk involved;
- Your stake in the business; and
- Whether you have provided security.

Banks take security to ensure you are committed to your business plan, and they are repaid if things go wrong. The most common types of security banks seek are:

- A mortgage over business premises; and
- A debenture. This can only be applied to a limited company, Limited Liability Partnership or farmer. It gives the bank a mortgage over all the assets of the business, including the book debts.

If you cannot offer sufficient security from the assets of your business, the bank may ask for personal assets such as:

- Personal guarantees by directors of limited companies;
- A mortgage over private property; or
- Life insurance policies, shares, and other investments.

If you are not able to provide adequate security, you could consider finance under the Government's Small Firms Loan Guarantee Scheme, as long as your business is eligible. Ask us or your bank for more information.

It is recommended that you seek independent advice from your accountant or solicitor before providing security.

Standards of service for borrowing

This outlines how banks set out to deal with their business customers when borrowing from them. High street banks have set out how they deal with their business customers, when they borrow from them, in their Statement of Principles. A summary of the Principles are listed on the next page.

Statement of principles

Banks will:

- Confirm the terms of any facility (borrowing, guarantees, bonds, etc) in writing;
- Remind you to seek independent advice;
- Co-operate with your advisers to explain the nature of any facility and to clarify anything during the relationship;
- Agree with you at the outset of the facility what sort of monitoring information you should supply and how frequently. If circumstances change, they will agree any new monitoring with you; and
- Alert you in writing when they have concerns about your business and/or their relationship with you.

In addition:

- If you are unable to solve the underlying problems, the bank may ask for additional financial information and / or seek an independent review of your business;
- If the bank asks for an independent review, they will explain their requirements to you and discuss the terms of reference, who should conduct the review, and the nature of the costs you are likely to incur;
- Where the bank has requested an independent review of your business, they will seek to discuss the information provided with you and, if requested, your advisors, before taking any action;
- The bank will add their support to a rescue operation which they believe will succeed;
- If you act in good faith, the bank will not normally seek the immediate appointment of a receiver, or start other recovery proceedings;
- The bank will act fairly, reasonably, and seek to resolve problems quickly; and
- You can appeal to the Banking Ombudsman (http://www.financial-ombudsman.org.uk) if you feel your bank has not kept to these procedures.

If you are not able to provide adequate security, you could consider finance under the Government's Small Firms Loan Guarantee Scheme, as long as your business is eligible. Ask us or your bank for more information.

It is recommended that you seek independent advice from your accountant or solicitor before providing security.

BBA advice for small business banking customers

The following information has been provided by BBA to help you understand, all the banking considerations you may face in starting up and running your small business, as well as providing a range of other relevant information and contacts, from start-up to selling and closing down your business.

Why open a business bank account?

It is recommended to open a specific bank account for your business, as this will ensure that your business is easily identifiable from your personal finances.

Opening a business bank account is the simplest way to achieve accountability and good degree of transparency in your business dealings.

A business account will also give you credibility as the bank has to a degree assessed and accepted your business proposal.

Tips on reducing your bank charges

The following list outlines ways in which you could reduce your bank charges:

- Manage your account better – ask your bank manager to suggest ways in which you could reduce your charges;
- Try to negotiate discounts in your account charging fees with your bank;
- Check your business' account balances regularly;
- Avoid unauthorised overdrafts;
- Earn interest;
- Complain when an arbitrary or excessive charge is made;
- Recycle your cash whenever possible – avoid paying in cash if you are going to need it again in a day or two;
- Use credit whenever possible;
- Get rid of those coins –keep the amount of cash credits and withdrawals to a minimum – cash is expensive so use services like BACS and standing orders. Ideally you should limit the amount of cash transactions you accept;
- Put several cheques received onto one paying in slip;
- Automate as much as possible – standing orders, direct debits, and BACS payments are usually cheaper than cheques;

- Go electronic – ensure your bank has quality electronic banking – this will reduce your account charges and make it easier to make and receive payments; and
- Shop around.

Things to consider when starting up or expanding your business

Below is a checklist of all the key considerations you need to take into account, including opening a business bank account and raising finance, when you are setting up or expanding your business:

- Assessing whether this is the right decision for you;
- Evaluating your business idea or concept;
- Conducting meaningful market research;
- Constructing a watertight business plan;
- Finding premises;
- Employing staff
- Legal and tax considerations;
- Opening a business bank account;
- Raising finance; and
- Keeping up to date with changes in the marketplace.

There are many sources of information and advice available to help you consider all these points in more detail.

Raising finance

Once you have drawn up your business plan, you will have a good idea of the capital expenditure and working capital needed to meet your set-up, or business expansion costs. If you have all the funds you need to get going that's great. But, even if you don't, there can be other solutions. Over and above your own funds, any extra finance may be available from your bank and other organisations.

Business Link advice for small business banking customers

The following information has been provided by Business Link: a government organisation that provides practical advice for businesses. Crown Copyright of the information is acknowledged.

Choose and run a business account

A good relationship with your bank is essential to the success of your business and this relationship has to be built up and managed. Choosing the right bank in the first place is vital.

The services offered by banks differ a lot, and so do the fees they charge. Some banks have special teams who deal with business accounts. They also have very useful information for start-up businesses.

Business Link provides a guide that explains how to choose and manage your business bank account. It can be found at www.businesslink.gov.uk/bdotg/action/layer?r.l2=1073858942&r.l1=1073858790&r.s=tl&topicId=1073959004

Transferring business accounts between banks

It's easy to stay with the bank you chose when you started up in business - but switching your business account could help you get a better deal.

Increased competition between banks trying to attract small-business customers, together with the development of telephone, PC and Internet banking, means there's a range of attractive packages available.

And moving your account should be more straightforward than before, with the agreement of many major clearing banks to make the process easier.

So if you've had a business bank account for some time, are you sure you're getting a good deal? And if you're not, how do you go about negotiating a better package with your bank or changing accounts?

Business Link provides a guide that answers these questions and is aimed at any business with a business bank account. It can be found at: www.businesslink.gov.uk/bdotg/action/layer?r.l2=1073858942&r.l1=1073858790&r.s=tl&topicId=1074405418

Foreign currency and exchange risks

If your business exports or imports goods or services, you need to consider how you will protect yourself against changes in the exchange rate. A tiny variation in the rate could potentially cost your business many thousands of pounds.

You'll also need to decide how to make and receive payments in foreign currencies. Is it sensible, for example, to open a bank account in a foreign country?

Business Link provides a guide aimed at businesses which regularly deal with foreign customers. It explains how to price goods or services, how to combat the risk of exchange rate changes and the practicalities of dealing in foreign currencies. It can be found at: www.businesslink.gov.uk/bdotg/action/layer?r.l2=1073858942&r.l1=1073858790&r.s=tl&topicId=1074298334

Debit and credit cards for your business

Making purchases with plastic cards is a convenient and flexible option for many businesses.

The different types of card available - from debit and credit to charge and purchasing cards - mean small-business owners don't have to carry large amounts of cash or a company chequebook and staff purchases can be effectively managed through the use of company credit cards.

Cards are widely accepted around the world and can help you keep close track of your expenditure. But with such a wide variety of cards on the market it can be hard to decide which is the best for you.

Business Link provides a guide that sets out the advantages and disadvantages of using company or corporate credit and debit cards and gives advice on how to choose the right card for your business. It can be found at: www.businesslink.gov.uk/bdotg/action/layer?r.l1=1073858790&topicId=1074298325&r.l2=1073858942&r.s=tl

Accepting debit and credit cards

Accepting payment by credit and debit cards is the norm for many businesses - particularly those selling to consumers. Cards are a convenient and flexible way for customers to pay and they are essential for telephone and online sales.

Accepting card payments has a number of advantages for businesses, from opening new sales channels to reducing the need to hold cash. However, you should check on transaction costs and balance these against the increased revenue you may gain by accepting cards. You also need to put precautions in place, as card payments can expose you to an increased risk of fraud.

Business Link provides a guide that outlines the advantages of accepting credit and debit cards in your business. It explains the steps involved in setting up the necessary systems and the actions you can take to avoid fraud. It can be found at: www.businesslink.gov.uk/bdotg/action/layer?r.l1=1073858790&topicId=1074407140&r.l2=1073858942&r.s=tl

Accepting online payments

For many small businesses, accepting payments online provides some major benefits. Customers increasingly expect this facility and it can improve your cash flow significantly.

It's easy to accept cheques or invoices for your online sales and to process payments in the traditional way. However, because buyers often use the Internet for a speedy service, most sales are paid for with credit and debit cards. To accept cards online, you will have to make special banking arrangements.

Online payments using cards are "card-not-present" or CNP transactions. There are higher risks of fraud with this type of payment and banks require you to operate within a well-defined set of rules and accept a higher level of commercial risk than a conventional swiped card transaction in a shop.

Business Link provides a guide that will help you to understand these requirements and look at the options available for taking advantage of online payments. It can be found at: www.businesslink.gov.uk/bdotg/action/layer?r.l1=1073858790&topicId=1073920405&r.l2=1073858942&r.s=tl

Types of funding available

The following list outlines the main sources of funding you may wish to investigate when financing your small business:

- Your Own Funds and Funds from Family Members
- Overdrafts
- Loans
- Small Firms Loan Guarantee Scheme
- Small Firms Training Loans
- Other Sources of Term Loans
- Leasing and Hire Purchase
- Factoring and Invoice Discounting
- Grants
- Venture Capital
- Business Angels

Each of the above funding sources is now described in detail:

Your own funds and funds from family members

Before considering external finance, consider whether you, your family or friends could finance the business.

When relying on friends and family:

- Make it clear that they should only give amounts they can afford to lose;
- Show them your business plan, and give them time to think it over;
- Discuss several 'what if' scenarios; and
- Put the terms of any agreement in writing.

But beware: do not risk what you cannot afford to lose, and do not ask your family to do so.

Overdrafts

An overdraft facility is the most flexible and simplest form of borrowing. This provides a business with short-term finance, but shouldn't be used for long-term borrowing, or to purchase fixed assets. Typically, an overdraft is ideal for covering the day-to-day costs of running your business. It also helps you cope with difficulties arising if your customers are late in settling their debts.

The advantages of an overdraft facility include:

- An overdraft is a simple and flexible way of financing changing cashflow requirements
- You only pay interest on the amount you are overdrawn each day

The disadvantages of an overdraft facility include:

- In principle, the bank can demand repayment at any time, although some banks do offer 'committed' facilities. Committed overdrafts provide more peace of mind over the standard overdraft as they are overdrafts the bank cannot demand back at any time.
- The overdraft facility has to be renegotiated every 6-12 months.

The interest rate charged is either a monthly rate, or at a rate which is linked to the Bank Base Rate and should be agreed at the outset. There may also be an arrangement fee. Remember to discuss the interest rate and fees with your bank.

Always speak to your bank to arrange an overdraft rather than risking an unauthorised overdraft - arranged overdrafts are much cheaper than an unauthorised one, and if you speak to your bank it shows you are in control.

It is important to be aware of the charges connected with exceeding the agreed overdraft level. Charges may be levied at a set amount per occasion, or per day, the overdraft is exceeded. Additional interest will be charged, and banks usually charge for informing you of this (by letter, telephone, or additional statement). There are also charges for returned cheques.

Loans

A loan is a suitable form of finance for longer term purchases, such as fixed assets including vehicles or essential business equipment. The loan term will be linked to the expected working life of the asset, or the source of repayment.

The advantages of loans include:

- Once you have arranged a loan, the financing is secure for the life of the loan (unless you fail to make payments or breach any 'covenants');

- You can match the term of the loan to the life of an asset you want to purchase;
- You may be able to tailor the loan to match the cashflow of the project you are using the loan to finance; and
- If your business is seasonal, you may be able to take a break in loan repayments.

The disadvantages of loans include:

- You pay interest on the full amount of the outstanding loan;
- The bank often imposes legally binding covenants before agreeing to a loan. If you breach these conditions, the bank will be entitled to immediate repayment; and
- The bank usually requires a fixed charge or some other form of security.

The interest rates may be fixed, remaining the same throughout the loan period. This assists accurate budgeting and protects your cash flow in times of rising interest rates. Variable interest loans are also available which are agreed at a rate over the Bank Base Rate which itself varies from time to time, or managed rates.

Capital repayment ‘holidays’ may be available. This would be especially helpful in the early months to give your business a chance to generate cash. However, interest is still charged during this period.

A pre-payment fee may be paid to cover administration costs if the loan is paid back early.

It is advisable to shop around when you decide you want to take out a loan. Compare the APR of every type of loan to find out which is the cheapest form of finance. Generally the lower the APR the cheaper the loan will be.

Small Firms Loan Guarantee Scheme

The Government’s Small Firms Loan Guarantee Scheme (LGS) supports promising businesses by providing a government guarantee against default. The scheme is intended as a last resort for sound business projects, that cannot get conventional financing because they cannot provide adequate security, or those that do not have a proven track record.

Loans are available for periods between 2 and 10 years on sums from £5,000 to £250,000. The ED guarantees 75% of the loan. In return for the guarantee the borrower pays the ED a premium of 2% per year on the outstanding amount of the loan. The commercial aspects of the loan are matters between the borrower and the lender.

To be eligible you must be a UK company with an annual turnover no more than £5.6m and have been trading for less than 5 years. Many business activities are eligible but there are a number of exclusions including buying a company's shares, buying out members of a partnership, replacing existing loan and overdraft facilities or financing interest payments. Loans are available to most business sectors; excluded sectors are listed later in this publication.

For more information speak to your bank or contact the Loan Guarantee Section at Small Business Service (Tel: 0114 259 7308/9). You can also ask for our publication: *IP 34-Small Firms Loan Guarantee Scheme.*

Other sources of loans

Other sources of loans are available from:

- Local Enterprise Agencies
- Local Economic Development Agencies in your business location; and
- Bank supported local finance schemes.

Leasing and hire purchase

Leasing and hire purchase are financial facilities that allow a business to use an asset over a fixed period, in return for regular payments. The business chooses the equipment it requires and the bank buys it on behalf of the business. Most business equipment may be obtained this way.

Hire Purchase

With hire purchase, after all the payments have been made, the business becomes the owner of the equipment, either automatically or on payment of an option to purchase fee. For tax purposes the business customer is treated as the owner of the equipment from the start of the agreement and so can claim capital allowances. The business customer will normally be responsible for the maintenance of the equipment.

Leasing

By comparison, the fundamental characteristic of a lease is that ownership never passes to the business. The bank claims the capital allowances and passes the benefit on by way of reduced rental charges. The business can generally deduct the full cost of lease rentals from taxable income, as a trading expense. As with hire purchase, the business will normally be responsible for the maintenance and insurance of the equipment.

- Long term or finance leases - Generally have a term of three years or more and when the lease ends the leasing company will agree to a secondary lease period at a considerably reduced or nominal rent.
- Short term or operating leases - Equipment can also be leased for shorter periods of time. The leasing company will expect to re-lease or sell the asset second-hand at the end of the lease period and will therefore not need to recover the full cost of the equipment from you. This type of lease is common where there is an established second hand market, such as cars and small items of plant and equipment.
- Contract-hire - A form of operating lease where the leasing contract also includes management and maintenance of the asset.

Leasing or Hire Purchase agreements are legal commitments and so cannot be withdrawn, providing the payments are made. However, it may not be possible, or may be costly to terminate agreements early. The regular payments allow businesses to budget their expenditure and easily compare the revenue and profit generated from an asset with its long-term cost. In most cases the agreements are at fixed rates of interest, although it may sometimes be possible to arrange variable rate interest on larger items.

Leasing or Hire Purchase can be a good way to finance an asset if your business lacks security, or there are tax reasons to do so. Remember however that banks will only enter into contracts with creditworthy businesses. A lease will normally cost you more than a bank loan or overdraft and involves a regular monthly commitment, but there may be tax advantages that make this a cheap way to finance an asset. Remember to compare the quoted APR, which each bank must calculate in the same way. For more details contact the Finance and Leasing Association - www.fla.org.uk.

Factoring and invoice discounting

Factoring and invoice discounting are financial facilities designed to improve the cashflow of healthy, growing businesses. They provide businesses with finance secured against their unpaid invoices. Under a factoring or discounting arrangement, a business sells its invoices to the bank when they are issued.

The bank pays the business up to 80% of the invoice value in cash, normally within 24 hours of receiving it. The remaining balance - less charge - is paid to the client business after a set period, or when the debt has been collected. The services can also be applied to export as well as domestic trade debts.

In both factoring and invoice discounting arrangements, a client business will establish a close relationship with its bank. It will receive regular credit assessments about its customers from the bank. The bank will also want to keep a close eye on the client's sales accounting and credit management function to check that it is operating efficiently and professionally.

For both factoring and invoice discounting there is a service charge, normally a proportion of turnover, and a discount charge, based on the amount of finance provided. Charges will be agreed in advance and form part of the factoring or invoice discounting agreement. For factoring the service charge is normally between 0.75% and 2.5% of turnover, depending on the workload to be undertaken. The charge for invoice discounting will usually be less, as less work is required. The discount charge is calculated on day-to-day usage of funds. It is likely to be comparable with normal secured bank overdraft rates.

The cost of the service needs to be weighed against the costs of in-house debt collection and, for example, having sufficient cash to benefit from early payment discounts from suppliers.

Generally, debt finance providers are looking for ‘clean’ invoices where there is clear evidence of delivery of the goods or service and a low level of disputes or credit notes. It may not be available for some industries, for example contracting, where there is a high level of retentions and variation orders.

Factoring and Invoice Discounting: Questions to ask the Bank

- How much will the service cost?
- How long will the agreement take to set up?
- How quickly will money be available against invoices?
- How quickly will you collect from customers?
- Who will be my day-to-day contact?
- Who will speak to my customers?
- How much notice must I give to terminate the agreement?
- Can you give me two or three references with similar businesses to mine?
- Can I factor export invoices?
- Are debts bought with or without recourse to me?
- Do I have to take out insurance against bad debts and, if so, can I choose who to buy the insurance from?

To terminate the factoring or invoice discounting agreement completely, however, and rely on alternative sources of finance for working capital, would require sufficient security for any potential borrowings.

Factoring and invoice discounting can provide a range of benefits for suitable small and medium sized companies. The main benefits include an increased flexibility, as finance is made available to your business in line with the level of its sales. This can help the client business to expand without exhausting its cashflow. This improved cashflow brought about by factoring and invoice discounting can lead to other benefits for a client business as follows:

- Takes advantage of early payment discounts or bulk buying from suppliers;
- Reduces the need to offer discounts to customers who pay early;
- Reduces management time to negotiate and re-negotiate finance and continually chase up late payers; and
- Can give a business greater confidence in planning its longer term capital investment.

Factoring

Factoring involves a business contracting out its sales ledger and debt collection to a bank. The bank will:

- Pay the business for its invoices when issued;
- Collect payments from its customers;
- Pursue late payers;
- Advise the business on the creditworthiness of its customers;
- Administer the business' sales ledger and credit management function;
- Protect the client business against bad debts (if required); and
- Optional protection against bad debts, up to agreed credit limits for each customer is also available.

Invoice discounting

By contrast, under an Invoice Discounting service, you continue to administer the sales ledger and the service is usually undisclosed to customers. Invoice discounting involves a business exchanging its invoices for cash, but little else.
The business will:

- Retain control of its sales ledger;
- Send out its invoices under its own name;
- Collect payments direct from its customers;
- Deposit the payments with the bank as soon as they have been received from its customers; and
- In some cases have optional protection against bad debts, up to agreed credit limits for each customer

Generally, invoice discounting is only available to businesses that already practice sound credit management and have the staff and accounting systems to generate reliable customer collections. For more information on factoring and invoice discounting, contact the Asset Based Finance Association at www.abfa.org.uk.

Grants

If grants are available for your business, then you should consider them before any other form of finance. They are a cheap way to finance your business.

However, bear in mind that there maybe some non-financial costs associated with grant finance. For instance, there may be conditions attached to the grant, such as the number and type of people to be employed, and the items on which the money can be spent will be restricted. Remember that grants are likely to be only part of a finance package.

For more information on grants available in your local area contact your local one-stop shop business advice network or gov-grants through www.govgrants.com.

Venture Capital

Venture capital is the term given to selling a share in your business to someone else. Your new partner might be a venture capital fund, another business, or a wealthy individual (business angel).

A sale of equity could help reduce the business' interest charges, but in the long run it may well be more expensive than other forms of finance. This is because your equity partner will require a high rate of growth and now owns part of the business.

However, the equity sale could help give the business balance. By selling equity you reduce the risk in your business, and you share the reduced risk with your new partner.

If your bank was reluctant to lend you money, this may be because you need more equity. Ask your bank for more details. Questions you should ask include:

- What is your equity partner looking for out of the deal?
- How quickly will they want to exit?
- Will they be able to finance the business through the next stage of growth?
- Will they 'add value' to your business?

For more information on venture capital contact The British Venture Capital Association

Business Angels

Business angels are individuals (or a group of individuals) who primarily invest money in a company. The investor often tries to bring 'added value' to the business in terms of business experience as well as financial assistance. Not all businesses will attract investment from a business angel. They are often looking for very specific types of business opportunity. Most business angels will require ambitious, entrepreneurial types with high growth prospects. However, they may also require a business within a certain industry or region. For more information contact the British Business Angel Association at www.bbaa.org.uk.

Which finance option is best?

Factors to take into consideration when deciding which finance option to select include:

- Shop around, and check out all the options;
- Leave enough time to raise finance as it always takes longer than you expect. Start the process 4-7 months beforehand, or even longer if you do not already have a business plan;
- Negotiate for a lower interest rate and lower charges (even if you have only received one offer of finance);
- Never reject a request to invest in your business out of hand – at least discuss it;
- Never accept a finance option without fully researching the implications of your decision;
- Never accept a finance option from someone with whom you do not feel you can work closely;
- Raise enough cash to meet the cashflow needs of your business (realistically assessed), not just the investment needs;
- Assess whether finance is a short or longer term need;
- Evaluate whether the business can afford regular repayments; and
- Assess whether the request looks reasonable to outside financiers in relation to track record / size of business / existing borrowing.

Resources for small business owners

Banks' small business websites

Most banks provide specific information to small businesses via their websites.
This includes:

- Details of their products and services;
- Advice and information on starting up and running a small business;
- Details of their online banking services; and
- ATM / branch locators.

Contact your local bank for more details:

- Alliance & Leicester Commercial Bank www.alliance-leicestercommercialbank.co.uk
- Allied Irish Bank - www.aibgb.co.uk/business/business-banking-uk.html
- Bank of Ireland - www.bankofireland.ie/html/gws/business
- Bank of Scotland - www.bankofscotland.co.uk/business
- Barclays Bank - www.smallbusiness.barclays.co.uk
- Clydesdale Bank - www.cbonline.co.uk/business
- Co-operative Bank – www.co-operativebank.co.uk
- HSBC Bank - www.banking.hsbc.co.uk/business
- Lloyds TSB Group - www.lloydstsbbusiness.com
- National Westminster Bank plc - www.natwest.com/business.ashx
- The Royal Bank of Scotland - www.rbs.co.uk/business.ashx
- Yorkshire Bank - www.ybonline.co.uk/0,,66195,00.html

Key Government websites

BIS[2]

The Department for Business, Innovation & Skills is the UK Government department with the overall aim, *"to increase competitiveness and scientific excellence in order to generate higher levels of sustainable growth and productivity in a modern economy"*.

Visit the BIS website (www.berr.gov.uk) to find out details on:

- Improving or expanding your business;
- Innovation and technology;
- Environmental matters;
- Particular industries;
- Regulations; and
- European matters.

Business Link

Business Link is a government-funded service designed to promote enterprise and can help running businesses, growing business or businesses just starting out.

Research shows that a business that uses professional external advice is likely to increase its turnover and profitability more than one that doesn't.

Harnessing the benefits of the range of business support services available in the market is a huge task for any business owner; time to understand, research and select what best suits their business needs now and for the future.

Business Link aims to provide relevant services from the broadest range of public and private sector business support services at a national, regional and local level. All their support is independent and impartial, and most services are provided free of charge.

Their website which can be found at www.businesslink.gov.uk contains more than 500 guides and 40 interactive business tools to help you start, run and grow your business.

It includes information on:

- Starting up
- Finance and grants
- Taxes, returns & payroll
- Employing people
- Health, safety, premises
- Environment & efficiency
- Exploit your ideas
- IT & e-commerce
- Sales and marketing
- International trade
- Grow your business
- Buy or sell a business
- Your type of business

Regulations, licences and contacts specific to your business area

Companies House

Visit the Companies House website (www.companies-house.gov.uk) to find out how to select and register business names and audit requirements of accounts of limited companies.

Tax, NIC and VAT

Visit HMRC website (www.hmrc.gov.uk) to find out more about tax, national insurance and VAT and customs and excise information.

HM Treasury Department

This department (www.hm-treasury.gov.uk) is responsible for formulating and putting into effect the UK Government's financial and economic policy. Information is provided on key economic and employment policies and initiatives.

Further Information

This guide is for general interest - it is always essential to take advice on specific issues. We believe that the facts are correct as at the date of publication, but there may be certain errors and omissions for which we cannot be responsible.

References:

[1] The main source of the material in this publication has been derived from the BBA website the copyright of which is duly acknowledged. Other references are derived from Business Link and Crown copyright therein is acknowledged.
[2] The Department for Business, Innovation & Skills (BIS) was formerly known as the Department for Business, Enterprise and Regulatory Reform (BERR) and before that was called the Department for Trade & Industry (DTI).

Important Notice

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