

# Understanding small business financing

Whether you need money to buy stock or equipment, require working capital to employ more staff or to fund a contract, or are simply looking for assistance to bridge your cash flow gaps while you are building your business; you can't secure the finance you need, it will have a huge impact on sustainability and growth of your business.

By [Darlene Menzies](#) 2 Dec 2019



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Research consistently shows that access to finance is one of the primary necessities for business sustainability, and is vital for achieving business growth.

In South Africa, while there is plenty of finance available for entrepreneurs of growing businesses, many still struggle to secure it.

If you are needing to raise finance for your business, it is best to start by getting to grips with the financing landscape. It is essential to do your homework and find out what finance options are available, which ones fit your needs and who the lenders are that provide these products.

If you adopt this approach to seeking finance, you will save yourself hours of wasted time and a frustrating run-around, the disappointment of rejected applications, not to mention the risk of business failure.

SMME financing is not a one-size-fits-all solution. There are different types of lenders offering different types of finance products that are specifically tailored to address different financial needs, across a range of different business types, stages and sizes.

## Different types of finance providers

Growing small and medium businesses have a number of different types of finance providers to approach to raise capital.

These include banks, debtor financiers, trade financiers, niche lenders, merchant financiers, venture capital companies and private equity firms, as well as government funding agencies and other development finance institutions.

Startups and early-stage businesses, on the other hand, are typically funded through personal savings, loans from

friends/family or bootstrapping. A small percentage manage to secure money from angel or venture capital investors, and there are also government funds that specifically support startups and early-stage businesses.

When it comes to government funding, the focus is on supporting businesses that are aligned with their key objectives such as job creation, wealth creation and improved wealth distribution across the population groups, increased export markets, and improved economic participation for previously disadvantaged people. They also prioritise funding for businesses in specific sectors that are deemed to promote economic growth, as well as support innovation.



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### **Different types of finance products (funding options)**

There is a range of different finance offerings for the growing small and medium business market.

Some of these include:

- Term loans (where lenders give you money for a fixed period and charge you interest)
- Customer deposits (where customers pay a percentage of the contract upfront to use as working capital)
- Personal and business credit cards
- Personal and business overdrafts
- Revolving credit facilities
- Debtor finance or invoice financing (borrow against a customer invoice while you wait to be paid)
- Supplier finance (supplier gives you the supplies on credit for a fixed period)
- Asset finance (where you can rent or lease equipment/machinery or take out a loan to buy the equipment)
- Equity finance (lender buys shares in your company)
- Contract finance
- Trade finance (import and export funding)
- Retail finance (provides funding against your credit/debit card income or subscription income)
- Finance from manufacturers (some manufacturers have their own financing division and offer finance to rent or buy the machinery or equipment)
- Venture capital
- Property finance
- Innovation finance
- Grants
- Incentives
- Loans

It is necessary to understand that one finance option can address multiple funding needs.

For example, a term loan can be used to fund working capital, business expansion, the purchase of equipment and machinery, franchise funding (depending on the amount of finance needed) or buy out a partner, to name a few. Likewise one finance need can be funded by various finance products e.g. if you need working capital, this can be financed via a credit card facility, overdraft or revolving credit facilities, customer deposits, debtor finance, supplier finance, contract finance, equity finance or Government grants, amongst others.

Another key determinate when it comes to deciding on the right finance product is the term or time period that the finance required for. The difference between short-term or long-term financing is closely tied to the reason the money is needed, and the amount of finance required.

Short term finance usually addresses requirements such as cash flow assistance that is likely to last for only a few months

working capital to fund a project for 6 to 12 months, or possibly the purchase of office equipment over 12 to 36 months. Short-term funding options include invoice financing, contract finance, overdrafts, credit cards, revolving credit facilities, supplier credit and asset finance.

Long-term finance, on the other hand, is more closely linked to business growth and expansion plans, rather than cash flow bridging. These types of funds involve larger sums of money, and repayment terms are from 5 to 10 years but may be longer depending upon the amount of the loan and the reason for why the finance is needed.



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## Different forms of funding

When you consider the different lenders and finance products available, it helps to start with what form of funding you would prefer. Broadly speaking, business funding falls into three categories, namely, grant and incentive funding, loan finance and equity finance. Each has its pros and cons.

### Grant and Incentive Finance

A grant is a sum of money that is given to you that does not have to be repaid. Grant funding is most commonly offered by the government and can range from 35% to 100% of the total funding application. Payments for grant funding are usually received in tranches (portion payments) once it can be proved that you have delivered the milestone that corresponds with the tranche payment.

The pro is that it is money for free, the downside is that it usually takes a long time to receive payments, by which time you have often run short of working capital. Always make sure you have cash flow contingency plans if you have been awarded Government grant funding.

Incentive funding usually requires that you pay for the costs yourself, and can then claim back a portion of the total costs apply for tax relief up to a certain percentage of the project costs.

### Loan Finance

A loan is a sum of money that is borrowed by the business from a lender. Loans are provided for a defined period with interest charged at an agreed rate. Loans have to be repaid to the lender, and strict penalties for late payments or defaults apply.

The pro is that repayment periods are lengthy, and usually in line with your submitted cash flow plan. The negatives are that the qualifying criteria are usually very onerous (requiring good credit records and strong business plans), and once you secure the loan it can be subject to high-interest rates.

### Selling Shares

This is where a lender provides the sum of money you are needing to raise, in exchange for giving them an agreed share of your business. The money that is received is not a loan, it does not need to be repaid. The lender owns the shares and the money belongs to the business.

The pro is that you get the money upfront, in most cases, and you have the working capital needed to grow your business at no financial cost. The downside is that you have to give up shares in your business and have to bring new partners into your business.

If you go this route, make sure you opt for 'smart money', meaning you choose a financial partner who adds more than just

money. They should bring with them access to market opportunities, introductions to business networks and experienced business input. Key to the success of equity finance, in the long run, is that you respect your funding partners and enjoy working with

## ABOUT THE AUTHOR

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