

The alternatives to conventional lending

Financial constraints have long been identified as one of the biggest problems impeding the growth of small and medium-sized enterprises. However, when it comes to raising new finance, many do not even know where to turn for help.

"The biggest challenge facing any entrepreneur is generating cash and keeping it flowing. There are obviously a number of ways of generating more cash but the first step is for businesses to make more money themselves by increasing margins. This is by far the best way to increase profits without increasing the work load. If this is not possible then businesses will need to look at external funding. All too often those businesses with a short-term need for additional cash will apply for a bank overdraft with interest levied daily, but a high overdraft is not the most desirable option as it can be expensive as well as restricting.

Conventional lending is becoming evermore restricted which means that SMEs must seek alternative avenues of generating cash.

If cash flow is suffering while SMEs are waiting for customers to pay their invoices, they can turn to factoring companies. SMEs lose an estimated £6.5bn every year due to unpaid invoices, but factoring companies can turn up to 80 per cent of the value of each sales invoice into cash within 24 hours. Factoring companies can also manage the tedious process of issuing invoices and collecting payments and can help to eliminate the risk of bad debts affecting the company's turnover. However, businesses must be aware of service charges. These are usually expressed as a percentage of sales factored and there is also an interest charge for the cash advances. These charges cover sales ledger management, collections services and bad-debt protection and can range between 0.6 per cent and three per cent of turnover.

SMEs looking for significant backing may consider approaching a venture capitalist. These are professionally-run fund management companies that invest in long-term, open-ended opportunities that are often considered too high risk for traditional bank funding. In return for their investment, they usually ask for equity in the business and typically take a seat on the board. In other words, instead of charging an SME interest as a bank would, they instead expect a share in the profits when the company succeeds.

Business angels, or private investors, work in similar ways to venture capitalists and can also provide SMEs with external funding.

Both venture capitalists and business angels look for high-growth companies with a strong management team to invest in. They also like to know what their exit route is. The main advantage of using a business angel is quick decision making without complex assessments, the disadvantage being they do not make investments regularly and may not be actively looking for an opportunity to invest. If an SME requires heavy investment in plant or equipment, leasing or asset finance is always a good option. This way, business owners can spread the cost of paying for a major purchase over the working life of the equipment and keep valuable cash free for use in other parts of the business. There are always options if you know where to look for them.