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Case Study



Examining Sources of Funding for a Business Start-up





key learning outcomes

- 1 Different sources of finance explained
- 2 Debt (bank finance examined)
- 3 AIB case studies
- 4 Applying for bank finance

introduction

Allied Irish Banks (AIB) is a large commercial bank operating in Ireland. It provides financial products and solutions in the personal and business / corporate markets. With over 200 branches across the republic of Ireland, AIB is one of the largest commercial banks in the country.

This study focusses on the different sources of funding available to support business and help them develop, manage their cash flow and expand. In particular, Dept Finance (bank finance) is examined and the mechanism for accessing it is outlined. The case study further looks at two Small to Medium Enterprises (SME's) and examines their financial needs going forward.

business finance



Starting and / or running a business is not an easy task to undertake and there are many challenging aspects to consider. One such aspect is raising the finance your business needs. Whether it be to get the business off the ground or to take it to the next level, capital is crucial for all businesses who wish to grow. It can help to manage cash flow, fund new equipment, and generally assist in growing a business.

There are many options available for businesses looking to raise finance for their business. The type and amount of finance that can be raised will be determined by (a) the credit-worthiness of the business, (b) the purpose for which the money is required, (c) the risks associated with the business and (d) the collateral available to support an application for finance.

There are three main types of finance available to a business: equity finance, grants and bank (debt) finance.

1

Equity Finance

Equity is the money invested in the business by the business owners or their friends, family, business contacts or investors. People invest in the business in return for shares making them a shareholder. This type of finance has no other cost other than spreading the ownership, and possibly the control, over more parties. With equity finance, the investors hold all the risk i.e. if the company goes out of business, their investment will not be repaid.

2

Grants

Grant assistance is available for both Start-up companies and business development or expansion. Funding is also available to undertake Research & Development and is managed in Ireland through Enterprise Ireland. A grant does not require a business to make repayments or require owners to give up a stake in the company. A grant is given to facilitate the development of a product, service or goal which the provider believes is worthwhile and of benefit.

3

Debt (Bank) Finance

Debt (Bank) Finance involves borrowing money to be repaid plus interest. This includes loans, asset finance, mortgages etc. The risk of debt finance is with the borrower. This means if repayments are not made, the business or assets belonging to the business may have to be sold to repay the debt to the bank. These assets are called collateral and are provided as security for the loan during the application process. The amount the firm may be able to borrow will be determined in part by the amount of collateral provided.

debt finance

For the remainder of this study we are going to focus on the debt financing options that are available to businesses as well as what the business should do if applying for finance. We will also look at some of AIB's business customers and discuss how debt finance can help companies like these to get set-up and grow.

Debt finance options are split into three core groups based on the length of time likely taken to repay the debt:

Short term finance options must typically be fully repaid within one year (e.g. bank overdraft).

Medium term finance options typically are repaid within three to four years (e.g. business loan).

Long term finance options take more than five years to repay (e.g. commercial mortgage).

In order for a business to successfully obtain bank finance it must demonstrate that:

- 1 The business can generate sufficient funds to meet the cost of the capital (interest) and proposed loan repayments.
- 2 It can continue to provide an adequate return to the business and / or other business partners, and
- 3 Show that the business is viable and can survive the medium to long term.



debt finance options

Financing options currently offered by AIB.

Asset Finance

Asset finance is suitable when you need to buy or upgrade equipment, plant, heavy goods or vehicles. It can help overcome the challenges of raising the necessary capital to purchase new assets.

Finance agreements can be organised over different periods of time, depending on what suits both the organisation and the cash flow requirements. Borrowers can choose the term that suits them best. Asset finance offers a practical and tax-efficient way to get the asset that a business wants, for new or used items.

Hire purchase is a good example of asset finance commonly used by businesses. It is an agreement whereby a person hires goods for a period of time by paying instalments. Ownership of the item only passes with the last payment of the agreement. The asset itself is the security / collateral for the finance borrowed to buy it. This form of finance is often used by businesses for company vehicles as the full cost of the vehicle does not have to be paid up front.

Overdraft

An overdraft is designed to help business customers with short term finance such as working capital needs. A business overdraft allows a business current account to go into an overdrawn position (an additional amount of money that can be drawn from a current account when it is in debit) up to a pre-agreed limit. While there is no fixed repayment period in place, an overdraft is subject to annual review after which time it may be renewed.



Business Loans

A business loan is simply when a company receives capital from a bank to be paid back with interest in an agreed timeframe. Business loans can vary in term from one year, to as long as 15 years. The rate of interest will vary from one lender to the next. AIB offers various business loans to suit the needs of a range of different businesses. One such example is the AIB Start-Up Loan.

A start-up loan is funding given to a start-up or early stage business, (i.e. Sole Traders; Joint Traders; Partnerships; Limited Companies) including farmers, established in the past three-years. The start-up loan can be used for the:

- Creation or expansion of early stage small businesses, including farming - e.g. new entrants to a particular sector, etc.
- Purchase of business assets.
- Matching funds required to secure State Grants.
- Investment in business infrastructure.

The amount of the loan taken out with the bank will depend on the company's business needs. The loan will be subject to the annual variable rate of interest which is subject to change and this needs to be taken into account when deciding if the particular loan is sustainable for the company.

Short Term Finance

accrued expenses
bank overdraft
trade credit
invoice discounting

1

Medium Term Finance

hire purchase
leasing
medium term loan

2

Long Term Finance

grants
debentures
equity capital

3

Company 1 – Newsagent

Company 1 is a small newsagent located in rural Ireland. It is owned and run by Sean, who inherited the business from his father back in 2015. His father opened the shop over 30 years ago, and it has been serving the people of the local town ever since. At first, Sean's father ran the store on his own, but as he got older he took on some additional staff to help out - one full time employee, and one part time employee.

When he was in secondary school, Sean would spend his summer holidays working for his father in the shop so working in the shop and serving customers was something that he enjoyed and was used to. What was a challenge for him was learning to run the business as well as manning the shop floor. Doing business with suppliers, managing employees and being responsible for the financial requirements of the business were all new to Sean at the beginning, but after two years he has found his feet and is ready to grow the business.

Over the past few years the population of the local town has been growing and as a result a large supermarket was opened within five minutes from Sean's store. Due to their lower prices and larger selection of brands available in store, some of Sean's customers have started shopping at the supermarket.

To compete with this new competitor, Sean plans to extend his store and add a deli counter, as well as do some renovation work to make the store more appealing to younger customers. To run this bigger store will require more staff members.



Having additional staff creates finance issues of its own, which need to be addressed at the end of each month. With extra employees, a staff canteen will be needed and staff wages and government tax bills need to be paid. To do this, the company needs to have enough Cash Flow at the end of each month to meet their debtors. This might include rent requirements, payroll, tax and PRSI bills. If the company is not generating enough Cash Flow they will need to consider how to finance it, whether by a short-term loan, or an overdraft facility.

Companies in high-tech sectors may look to grants and equity funding when starting up or expanding, but companies in the retail sector are more inclined to look at the option of debt finance as a solution to new purchases or cash flow issues. For example, if the business needed some new, high end technology equipment for the deli counter but did not have the cash to pay for it upfront, they may need to source debt finance to acquire the equipment.

Company 2 – Landscape Gardening

Best friends Ben and Colm started their landscape gardening business in 2016. They met five years prior to this when they both worked as apprentice landscape gardeners for a business just outside Galway. It was here they learned their trade and developed the desire to have their own business someday. After saving for a couple of years, Ben and Colm moved to Dublin to start their business.

Operating out of Colm's parent's garage in South Dublin, they invested an initial sum of money into the business to get started. This capital enabled them to purchase the various pieces of equipment needed (shovels, lawn mowers etc.). It also covered the cost of an ad in the local newspaper as well as some leaflets. They started by personally handing them to people in the local area whenever they could.

From there, one or two jobs a week has quickly become one or two per day as the quality and attention to detail of the service is attracting more and more attention in the community. This has stretched the resources of the business to the point where if they do not grow with the demand they will risk having to turn down potential customers.



To help meet this demand the owners plan to take on another experienced landscaper, as well as a trainee. They also plan to purchase additional equipment and a new company van.

So far, Landscape Gardening has been entirely self-funded. To grow the business, capital will be needed to buy additional equipment, vehicles and to support the payroll cost of additional staff. If Landscape Gardening decide to raise finance, it will avoid the need to use available business cash flow to fund these activities.

applying for bank finance

When applying for bank finance, business owners will need to convince the bank it is a good investment. The following should be covered by a business when approaching a bank for any type of Bank Finance.

Background

Details of the business, including business activity, ownership, management team, history, location, and who the key stakeholders are e.g. customers, suppliers, competitors etc.

Purpose and Vision

An explanation of how finance from the bank will help the business. The business should provide clear future objectives, both short term and longer term.

Risks

The business needs to show how it understands the risks that affect it and prepare an outline of the steps taken to reduce these risks, both internally and externally.



Financial Information

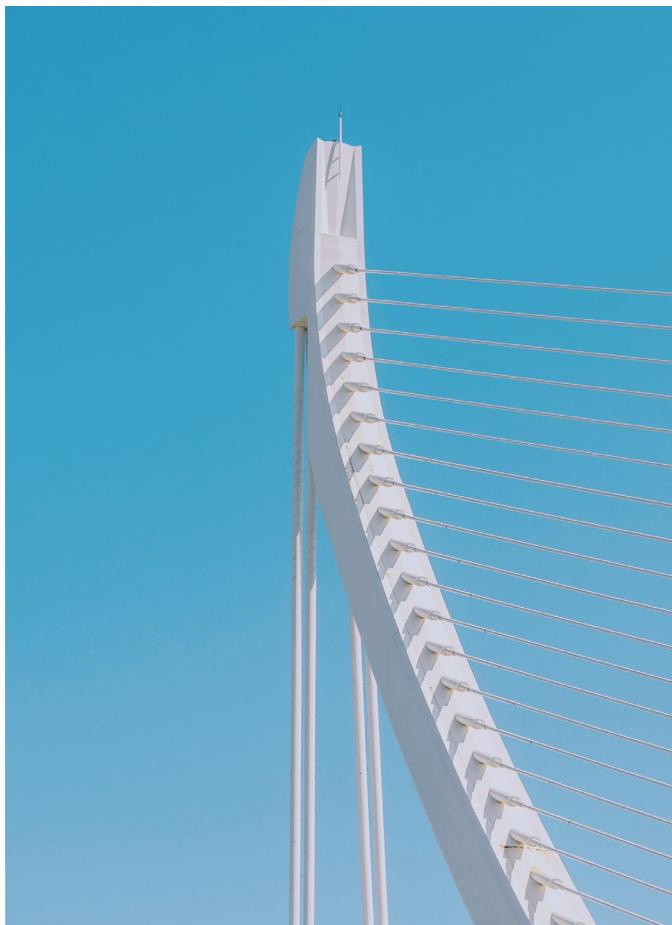
Historical financial information in the form of audited accounts and, where appropriate, the following information:

- a Management accounts for the current year
- b Cash flow forecast for the next three years
- c Breakeven Analysis
- d List of Debtors / Creditors
- e List of collateral available
- f A breakdown of current borrowings and savings will also need to be provided to the bank. If the business is a new start up, additional pieces of information may also be required to support the application.

conclusion

Every business will need to source finance at various points during its lifetime. The choice of finance can have a huge impact on the future of the business. A decision must be made between debt and equity finance.

This case study has shows that there are a number of finance options available which a business could use for the many different needs that may arise. The choice depends on different factors, such as the amount of finance required, the history of the company, the collateral available and the purpose of the finance. Potential borrowers should always consider the range of available options in order to make an informed choice.





activity

- 1** Discuss how the finance options available from AIB would be of use to:
 - a. Company One: Newsagent
 - b. Company Two: Landscape Gardening

- 2** Evaluate the factors which these two companies would have to consider when applying for finance.

- 3** Choose an SME in your local area. Explain what are the possible sources of finance most relevant to the organisation, and evaluate why they might choose them.

about

BusinessEducation.ie is an online resource created for Leaving Cert Business, Economics and Accounting students and teachers. The site contains a wide range of support tools including:

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- Up-to-date economic indicators for Ireland including definitions and commentary
- Links to the important business news stories of the day
- Email alerts when new content is added

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