Demystifying small business funding

By Rean Bloem

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Small businesses have been disproportionately affected by the Covid-19 pandemic. They have had a rough ride over the past two years and many who have managed to stay afloat will agree that access to the right financing at the right time was instrumental to their survival.

Source: Pexels

During the Covid-19 pandemic, many businesses applied for funding to facilitate e-commerce platforms or pivot the business and it's no coincidence that those who managed to keep their doors open did so by acting quickly on the challenges and opportunities that presented themselves - by accessing finance fast.

For small business owners and entrepreneurs, there has never been a time when a thorough awareness and knowledge of the different financing options available to them has been so vital.

The general perception among small business owners is that accessing loans is difficult and limited to the traditional banking fraternity, that applying for financing is complicated, and that they would need substantial collateral to obtain the financing. This is only true if they are approaching formal lending institutions such as banks for a business loan.

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Key factors determining success when applying for business finance

A good credit profile is key. Small business owners who buy supplies or other materials from third-party vendors would do well to pay on time as those purchases could help build their business credit profile. This is relevant to all lines of business credit too.

A digital footprint opens many doors. If an SME uses e-commerce tools and paypoint technology such as POS card terminals to trade, it increases their chances of obtaining funding fast. This allows funders to make quick assessments to grant funding.

Determining the best type of funding for your business

Understanding the difference between a small business loan and small business funding is a good first step.

The key differentiators are that a loan will generally have rigid conditions attached to the payment terms - especially with regard to what the money can be used for e.g. a five to 10 year payment period, and the business would need to provide security in some form.

With funding the scenario is very different. Access is far easier, payment terms are far more flexible, a funder will not require any security from the business, and the business owner can decide - along with the funder - how best the money can be invested back into the business. Also, with funding, payment can be linked to the business turnover, allowing the business owner to pay back the full amount earlier, thus bringing down the total payment.

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There are a number of financing options available to SMEs depending on whether the business is in the business plan or idea phase, start-up phase, growth/established/expansion phase or in a mature state. Small business owners would do well to familiarise themselves with the various options in terms of risks and benefits related to the lifecycle of their business.

1. Private loans from family/friends

These loans are often unstructured and limited to the amount available. There could be an expectation that they will be paid back within a very limited time at a rate of interest higher than through a financial institution.

2. Bank loans (overdrafts or fixed period loans)

The amount available from bank loans is limited by the security the SME can offer against the loan. This usually takes the form of property, fixed assets, and insurance policies.

3. Term financing such as hire purchase or leasing

Very similar to bank loans but for term-financing of moveable assets it will be the underlying asset item that is funded.

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4. Private/quasi-equity investment

Private investments are offered based on the potential for success in the market as per the presented business plan and the ability or track record of the operator/entrepreneur.

5. Asset finance

Often, businesses don't have the working capital available to pay upfront for an asset. That's where asset finance can come in handy. There's a range of traditional asset finance products available that includes Hire Purchase, Equipment Leasing,

6. Merchant cash advances

This type of business funding is designed to help businesses gain access to the cash they need in a fast and flexible way. The lender provides the business with funding which it pays back through a percentage of its future turnovers/receivables.

The funding does not require any security and is unrestricted, meaning it can be used for working capital or asset finance but ultimately it is at the discretion of the business owner what they use it for.

ABOUT THE AUTHOR

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