# Structuring finance for success

**Interlease's Gary Wilkie elaborates on the importance of why structuring your business finance correctly is vital for business success and peace of mind.**

When we first start out in business we have an idea to develop a business using the expertise we possess, however with most new businesses funds are short and we typically require some capital to kick start the business to support purchases such as equipment, factory space and service vehicles and the first port of call for most new business owners is the place they got their home loan from, their bank. Being a new business when the bank agrees to assist us we are grateful for this funding.

However, once a business matures, it requires a different set of funding fundamentals and its financial needs, obligations and capabilities require a new perspective. For example, the focus needs to shift from obtaining finance to get the business underway to minimising the amount of security required to purchase specific assets, which the company may want. For this reason it pays to review your financial structure every few years to ensure you are operating as efficiently as possible.

Let's have a look at a typical example of a small business which needs to raise finance and the options they have available to them.

### Option One – Single Source Funding

Option one is the path most small businesses take and that is to go to their personal bank and request the finance.

- First mortgage on the house. Assume the house is valued at $500K, with a mortgage of $253K
- First mortgage on the factory. The factory is worth $800K, with a mortgage of $350K
- An overdraft facility secured by the house and factory
- Motor vehicles. These include directors and service vehicles to the value of $100K
- Equipment for the business. Equipment is imported from overseas and valued at $500K.

Therefore, the ratio of the equipment to the assets can become out of balance. Most capital equipment is purchased for about $250K to $500K. If you then add all the total exposure you have with a particular bank it can easily amount to $1.5M to $2M dollars. To have this kind of exposure with any one funder is not an ideal situation.

### Option Two – Use Multiple Funding

Another option is to start spreading the funding source around to provide some flexibility.

- First mortgage on the house. Assume the house is valued at $500K, with a mortgage of $253K – funded by bank (a)
- First mortgage on the factory. The factory is worth $800K, with a mortgage of $350K – funded by bank (a)
- Business overdraft facility – funded by bank (a)
- Motor vehicles. These include directors and service vehicles to the value of $100K – funded by bank (b)
- Equipment for the business. Equipment is imported from overseas and valued at $500K – funded by banks (c,d,e).

Perhaps a rational way of doing it would be to put the equipment, such as a beam saw, with one funder, an edgebander with another funder and so on until you have $500K worth of equipment financed with three different funders.

The advantages of using multiple funders is as follows;

- You do not have large exposure with any one funder
- You have credit ratings with five different funders
- You can develop a good track record with five different funders
- You can choose to expand your business through finance using your financier of choice.

### Option Three – Use Multiple Funding to free the home

Another option is to use the equity built up in the factory and the income generated by the business to free the mortgage on the family home.

- No first mortgage on house valued at $500k
- First mortgage on the factory. The factory is worth $800K, with a mortgage of $603K – funded by bank (a) and debtor finance from the business income via monthly invoices
- Business overdraft facility – funded by bank (a)
- Motor vehicles. These include directors and service vehicles to the value of $100K – funded by bank (b)
- Equipment for the business. Equipment is imported from overseas and valued at $500K – funded by banks (c,d,e).

Additionally, by spreading the equipment assets, in the future, if there is downturn in business or you wish to diversify away from a particular line of work, you have the ability to sell off one piece of equipment at a time as required and pay off the debt attached to that piece of equipment.

Another reason to use multiple funders for equipment purchasers is that financiers like manufacturers are also specialists in particular fields. For example, the bank that finances your home, may have an enormous amount of expertise in residential property, but very little knowledge of equipment finance. A financier of equipment up to $50k, may not have the knowledge and connections to best structure the finance for an overseas equipment purchase to the value of $2.5m as another example.

Finally another disadvantage with single source funding is that when you are wanting an extra overdraft facility you have to negotiate on the total borrowing. If you use option one above as an example, if you have $1.5M exposure with a single funder and you require an extra $20K, you are not borrowing just $20K you are actually borrowing $1.5M plus $20K and therefore, the finance funder will need to do an assessment on $1.52M, rather than the $20K facility you are looking to borrow. This means you will need to have up-to-date financial, cash flows and projections available to proceed, which can be time consuming to prepare.

As you can see from the above examples, a regular review of your financial structure, combined with sound financial advice, may change the financial situation of your business and asset base and in turn save you a lot of effort and expense over time as your business evolves. -S-