

# Sources of Finance for Starting a Business

Business Information Factsheet  
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## Introduction

Many new businesses fail because they do not have enough cash to last them through the critical first few months of trading when their sales revenues are only just starting to build up.

Before business owners begin trading, they need to make sure they have enough money to set up the business and cover initial running costs. If they or their business partners don't have enough money themselves, they will need to approach other sources of finance.

This factsheet outlines some of the options available for sourcing external cash to help people start up in business. There are various sources of finance available, but for new start ups, the most likely options will be:

- Personal savings and informal loans from family or friends.
- Bank loans and overdrafts.
- Credit cards.
- Private equity investors, including business angels.
- Crowdfunding, where money is raised from large numbers of individual investors.
- Government funding schemes.
- Responsible finance providers (RFPs).
- Credit unions.
- Other independent business support organisations and schemes.

## Personal savings and informal loans from family or friends

Personal savings and money raised from friends and family are the most common forms of finance for start ups.

Friends and family may be prepared to help start ups by offering them a loan, particularly if it has not proved possible to get one from a bank. This may be on preferential or 'soft' terms, including the possibility of an interest-free loan. If friends and family offer a loan, but require interest to be paid, then there will be tax implications for both parties. In addition, personal relationships may be affected if the business does not do as well as planned and the business owner is unable to repay the loan on time or in full.

Relatives or friends may also consider investing money in a business in return for a share of its ownership, even if they act as a 'sleeping partner'. However, they need to understand that

they will be risking their capital and that returns are not guaranteed, so they should invest only what they can afford to lose. This type of investment also has implications relating to the legal standing of the business. See BIF032, *Choosing the Right Business Legal Structure*.

## **Bank loans and overdrafts**

Banks offer a variety of finance options, services and introductory offers to business start ups. For example, many banks offer an introductory period of free banking, and this can last for up to two years in some cases.

See BIF043, *A Guide to Opening a Business Bank Account*, for further information about how to open a business bank account.

### **Overdrafts**

Banks can provide finance in the form of an overdraft, whereby they agree to let business owners withdraw more money than they actually have in their business account. The bank will set a maximum level for the overdraft.

Firms only have to pay interest on the amount they are overdrawn, so overdrafts can be a good option if only small amounts of extra cash are needed at certain times during the month or year. However, the interest payable is often higher than the rate for a loan.

### **Loans**

Business loans are available through the main high-street banks and the recently established challenger banks, such as Metro Bank and OakNorth, and it is important to shop around for the best deal for both personal and business circumstances. Factors to consider include the amount to be borrowed, the rate of interest charged and the repayment period that is affordable. For a business start up, it is likely that the loan will need to be secured against a personal asset such as the proprietor's house or other property.

See BIF373, *A Guide to Debt Finance*, for detailed information about financing a business using an overdraft or loan.

## **Credit cards**

Some business start ups fund their short-term spending through the use of credit cards. This has been encouraged by the availability of competitive deals such as introductory interest-free offers. While many credit card providers discourage the use of personal credit cards for business purposes, there are now a number of credit card offers specifically targeted at new business owners.

Credit cards can help a business to finance its short-term needs, but they don't make sense for long-term borrowing. Although initial interest rates may be attractive, the interest costs of credit cards are usually higher than overdrafts and loans, unless the business owner can repay the outstanding balance each month.

## Private equity investors

Private equity is money that is invested in a business by a third party in return for a share of the ownership. This may be provided by a commercial organisation such as a venture capital firm or private investors who are known as business angels. This type of finance is available only to limited companies. Private equity funding is not available for start ups that operate as a sole trader or business partnership legal structure.

Private equity is not usually secured on a company's assets, so the investor faces the same risks as the other shareholders. If the business fails, they will lose their money. Investors achieve a return on their investment through the payment of dividends by the company and the value they achieve for their shares when they are sold.

## Venture capital

Venture capital is a means of financing a business where a proportion of the firm's share capital - or equity - is sold in return for a cash investment in the enterprise. It means that some measure of control or ownership over the business has to be given to the new shareholder. Most, but not all, venture capital investors are looking to make quite large investments, often over £1 million, which excludes them from providing finance to the majority of start ups. The British Private Equity & Venture Capital Association (BVCA, [www.bvca.co.uk](http://www.bvca.co.uk)) publishes a list of member firms, their contact details and the types of funding that they provide.

See BIF062, An Introduction to Financing Your Business with Venture Capital, for further details about venture capital.

## Business angels

Business angels are private investors who look for opportunities to invest money into new or growing small firms. Most regions of the UK provide services that match business angels with suitable start ups, which encourages local investment and mentoring on a small scale. The UK Business Angels Association ([www.ukbaa.org.uk](http://www.ukbaa.org.uk)) matches business angels with small firms requiring equity finance. Angels Den ([www.angelsden.com](http://www.angelsden.com)) runs regional workshops for young companies looking for angel funding. Business angels typically want to invest funds of between £10,000 and £100,000, although they can also form syndicates of investors who will invest larger amounts.

See BIF324, An Introduction to Approaching Business Angels, for further information.

## Equity-based crowdfunding

Crowdfunding is a method of financing that enables a large number of people to invest a very small amount of money in a business. A business seeking investment is usually matched with potential investors online via specialist crowdfunding platforms such as Crowdcube ([www.crowdcube.com](http://www.crowdcube.com)) and Kickstarter ([www.kickstarter.com](http://www.kickstarter.com)).

Equity crowdfunding enables groups of investors to receive shares in the business in exchange for their investment. The value of their stake in the business can go up or down, as with any investment in shares.

The UK Crowdfunding Association has published more information about crowdfunding, which can be viewed at [www.ukcfa.org.uk](http://www.ukcfa.org.uk).

## Government sources of funding

Various initiatives are operated by certain government departments and agencies that offer help to business start ups, particularly those involved in technology, research and development (R&D) and exporting.

### Grants

Grants provide finance to allow a business to undertake a specific project that, without financial assistance, would not be able to proceed. Such projects might involve the initial start up of the business, developing a new product or buying equipment.

A grant is usually a one-off payment and provides funding that covers a percentage of the costs of the project - normally the proprietor or the business will have to meet some of the costs too. Unlike a loan, a grant does not usually have to be repaid unless the business fails to comply with the specific eligibility requirements and conditions of the scheme. Business owners need to check they meet the eligibility criteria for a particular grant and consider what will be required to satisfy the funders' requirements. See BIF369, A Guide to Applying for a Business Grant, for detailed information about the process of securing grant funding.

The most widely available government-funded grants are for R&D, but various grant schemes are available in different regions of the UK:

- In England, go to [www.gov.uk/business-finance-support-finder/search](http://www.gov.uk/business-finance-support-finder/search).
- In Wales, go to <http://gov.wales/funding/grants/business/?lang=en>.
- In Scotland, go to <https://beta.gov.scot/policies/supporting-business>.
- In Northern Ireland, go to [www.investni.com/support-for-business/funding-for-business.html](http://www.investni.com/support-for-business/funding-for-business.html).

Some government departments, such as the Department for Environment, Food & Rural Affairs (Defra, [www.gov.uk/government/organisations/department-for-environment-food-rural-affairs](http://www.gov.uk/government/organisations/department-for-environment-food-rural-affairs)), and other organisations such as the UK's Arts Councils ([www.artscouncil.org.uk](http://www.artscouncil.org.uk), [www.creativescotland.com](http://www.creativescotland.com), [www.arts.wales](http://www.arts.wales) and [www.artscouncil-ni.org](http://www.artscouncil-ni.org)), may also offer funding schemes for business start ups in specific sectors.

### Start Up Loans

Start Up Loans is a national scheme that provides loans to people aged 18 and over to help them start up or develop a business that has been trading for less than 24 months. Loans are repayable over one to five years, and the interest rate is currently fixed at 6%. Loans of up to £25,000 are available, and the average loan amount is £6,000. Applicants for a Start Up Loan must be at least 18 years old and resident in the UK, with the legal right to remain in the UK for the term of the loan. Applicants must not have been, or currently be, declared bankrupt and/or have any outstanding Individual Voluntary Arrangements (IVAs). Mentoring and support are provided to successful applicants. Start Up Loans are delivered through a network of regional partners, such as Five Lamps in the north east of England and DSL in Scotland. Go to [www.startuploans.co.uk](http://www.startuploans.co.uk) for further information.

## **New Enterprise Allowance (NEA)**

The NEA is an initiative funded by the Department for Work and Pensions (DWP) that helps unemployed people to start up their own business in England, Scotland and Wales.

To be eligible, applicants must be aged 18 or over and be claiming Jobseeker's Allowance (JSA) or Employment and Support Allowance; applicants can access the allowance from the first day of their claim. Lone parents or people who are sick and receive Income Support are also eligible to apply. Some people who receive Universal Credit may also be eligible.

The NEA provides access to a mentor and financial support comprising a weekly allowance paid for up to 26 weeks (up to a total of £1,274). Participants on the NEA may also apply for a Start Up Loan, subject to status, to help towards the costs of starting their business. Go to [www.gov.uk/government/collections/new-enterprise-allowance-campaign](http://www.gov.uk/government/collections/new-enterprise-allowance-campaign) for further information about the scheme.

See BIF463, Government Financial Support for Business, for details of specific schemes.

## **Local authorities**

Some economic development departments (or equivalent) in local authorities may offer financial support to new and existing firms, including grants and loans. Many local authorities also provide managed workspace units that offer low-cost office space for new firms.

## **Responsible finance providers (RFPs)**

RFPs specialise in providing finance to new and growing firms that have been unable to secure finance through traditional providers such as banks. Most RFPs are members of Responsible Finance (RF, <http://responsiblefinance.org.uk>), which can provide further information and the contact details of the nearest RFP. RFPs were previously known as Community Development Finance Institutions (CDFIs).

## **Credit unions**

Credit unions are co-operatives that are owned and controlled by their members. Members must share a common aim, such as wanting to benefit their local community, working in the same industry or attending the same church.

The members of a credit union pool their savings to provide each other with credit that is charged at a low interest rate.

There are more than 500 credit unions in the UK, with an annual turnover of over £182 million. They distribute their profits to members in the form of dividends.

Some credit unions provide loans for small firms, especially for new business start ups. Go to <https://northlondoncreditunion.co.uk/business.html#startups> and [www.centralcu.co.uk/content.asp?section=232](http://www.centralcu.co.uk/content.asp?section=232) for examples of credit unions that provide funding for business.

The Association of British Credit Unions Limited (ABCUL) is the main trade body representing credit unions in England, Scotland and Wales. Go to [www.abcul.coop](http://www.abcul.coop) for further information and to find a local credit union. For information on credit unions in Northern Ireland, contact the Ulster Federation of Credit Unions (UFCU, [www.ufcu.co.uk](http://www.ufcu.co.uk)).

## Independent business support organisations

A number of locally based business support organisations administer a variety of schemes to help support new and expanding small firms. Many of the schemes include business planning advice, training and some form of financial support.

### Local enterprise agencies

Enterprise agencies provide advice and financial support to pre-start, start-up and micro firms. They will also be able to signpost to other local sources of financial support. Some local enterprise agencies are also responsible finance providers (RFPs).

The main types of finance provided by enterprise agencies are:

- Soft loans, which often require no security and are used to support viable firms that cannot raise all of the finance they need from other sources.
- Grants, which may have narrow eligibility criteria. For example, they may only be available in certain geographic areas, for certain business sectors, for specific types of people (for example, unemployed or young people), or for projects (such as marketing or buying IT equipment).

The National Enterprise Network is a network of independent local enterprise agencies in England. Go to [www.nationalenterprisenetwork.org](http://www.nationalenterprisenetwork.org) for a list of enterprise agencies.

The Welsh Government provides business advice via Business Wales. Go to <https://businesswales.gov.wales/business-wales-helpline> for further information.

In Northern Ireland, the work of enterprise agencies is co-ordinated by Enterprise Northern Ireland ([www.enterpriseni.com/lea-office-locations](http://www.enterpriseni.com/lea-office-locations)).

In Scotland, enterprise agencies are referred to as 'enterprise trusts'. Go to [www.scottish-enterprise.com](http://www.scottish-enterprise.com) for further information.

### The Prince's Trust

The Prince's Trust ([www.princes-trust.org.uk](http://www.princes-trust.org.uk)) helps young people aged between 18 and 30, who are unemployed or under-employed, to start up in business. The trust aims to support disadvantaged young people who find it difficult to obtain finance from conventional sources. The trust operates from regional offices, arranging advice and training, as well as grants and loans.

### Shell LiveWIRE

Shell LiveWIRE supports young people aged between 16 and 30 anywhere in the UK who are either planning to start a business in the next six months, or who are in their first year of trading. Shell LiveWIRE runs two business awards: the monthly £5,000 Shell LiveWIRE Smarter Future Award for start ups, and the annual £10,000 Shell LiveWIRE Young Entrepreneur of the Year Award. Go to [www.shell-livewire.org](http://www.shell-livewire.org) for further information.

## Hints and tips

- A local business adviser will be able to advise about the sources of finance available in the local area, and can help start ups and small firms to apply for finance.
- All providers of finance will need to be convinced about the viability of the business, and start ups will therefore need to produce a robust business plan that explains clearly how the business will operate and why the finance is required.
- Start-up proprietors should ensure that they can afford repayments on any loans, either personally or through business profit.
- Financial assistance, especially for business start ups, is sometimes dependent on the applicant attending business skills training courses, which not only improve their personal skills, but also increase the confidence of potential investors in their business.
- Eligibility for a particular grant should be checked before applying, as there can be strict qualifying criteria and the application process can be time-consuming.

## Further information

BIF004 A Guide to Writing a Business Plan

BIF032 Choosing the Right Business Legal Structure

BIF043 A Guide to Opening a Business Bank Account

BIF062 An Introduction to Financing Your Business with Venture Capital

BIF324 An Introduction to Approaching Business Angels

BIF369 A Guide to Applying for a Business Grant

BIF373 A Guide to Debt Finance

BIF442 A Guide to Support for Social Enterprise

BIF463 Government Financial Support for Business

## Books

'Raising Capital: Get the Money You Need to Grow Your Business'

Andrew J. Sherman

3rd edition, 2012

Publisher: Amacom

## Useful contacts

The Department for Business, Energy & Industrial Strategy (BEIS) is responsible for business support in the UK.

Tel: (020) 7215 5000

Website: [www.gov.uk/government/organisations/department-for-business-energy-and-industrial-strategy](http://www.gov.uk/government/organisations/department-for-business-energy-and-industrial-strategy)

Invest Northern Ireland is responsible for economic development in Northern Ireland.

Tel: 0800 181 4422 / (028) 9069 8000 (Belfast office)

Website: [www.investni.com](http://www.investni.com)

Scottish Enterprise is responsible for economic development in Scotland.

Tel: 0300 013 3385 / (0141) 247 1385

Website: [www.scottish-enterprise.com](http://www.scottish-enterprise.com)

The Welsh Government is responsible for economic development in Wales.

Tel: 0300 060 3300

Website: <https://businesswales.gov.wales>

The British Private Equity & Venture Capital Association (BVCA) provides publications, data and guidance on all aspects of private equity and venture capital funding.

Tel: (020) 7492 0400

Website: [www.bvca.co.uk](http://www.bvca.co.uk)

The UK Business Angels Association promotes UK business angels' networks and publishes a directory of members.

Tel: (020) 7492 0490

Website: [www.ukbaa.org.uk](http://www.ukbaa.org.uk)

The National Enterprise Network is a network of independent, not-for-profit, enterprise agencies and similar organisations that provide services to small and growing firms in England.

Tel: (01908) 605130

Website: [www.nationalenterprisenetwork.org](http://www.nationalenterprisenetwork.org)

Enterprise Northern Ireland co-ordinates the work of enterprise agencies in Northern Ireland.

Tel: (028) 7776 3555

Website: [www.enterpriseni.com](http://www.enterpriseni.com)

The Prince's Trust helps young people aged 18-30, who are unemployed or under-employed, to start up in business.

Tel: 0800 842842

Website: [www.princes-trust.org.uk](http://www.princes-trust.org.uk)

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