BAXENDALE

QUICK GUIDE TO BORROWING FOR EMPLOYEE OWNED BUSINESSES

Why Borrow?

EOBs will usually borrow for the same reasons as other businesses:

- to grow the business
- to invest in / acquire key assets
- to increase working capital
- to fund an exit

Being clear on your needs will be important when determining if you want to borrow and the nature of finance that you need.

In particular, there is a cost to borrowing and you will need to be satisfied that the return / benefit you generate from the funds borrowed will be worth this cost.

Types of Borrowing:

Overdraft / revolving credit facility:

These are usually to increase the working capital / cash available to the business. They can be useful to assist with short-term cash needs (for example if your business is seasonal and has a need for additional cash at certain times in the year). You would usually agree a limit and have access to this cash when you need it. Such facilities are usually short term and subject to regular review and potential withdrawal. You will usually need to pay a fee to have the facility, even if it is not used.

Invoice finance:

Also known as invoice factoring, under this you usually sell some of your debtors to the finance providers. You will sell them for less than their face value (this is how the lender makes a return) but get the cash immediately. This usually takes the form of a facility that is available to you over a period of time so that you can draw on it when you need it. The availability of such facilities may depend on the quality of your debtors.

Term Loans:

These usually take the form of shorter-term loans of up to five-year terms and longer-term loans with payment periods of ten or more years. The shorter-term loans are well placed to fund specific transactions or aquisitions, while the longer term loans are usually to fund particularly large transactions, such as the purchase of land or a large share sale.

Can I borrow?

Lenders' requirements have varied over time, however they will typically be interested in some or all of:

- Your ability to show a consistent track record of generating profit and cash.
- The value of any security that is available. Employees will not usually be in a position to consider personal guarantees, so this usually takes the form of assets owned by the business.
- Your level of profit and amount of loan. The costs for the lender are often similar for each loan, irrespective of its size. This can make smaller loans to smaller business uneconomic for some lenders.

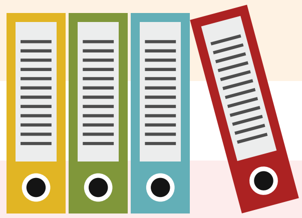
These criteria can vary over time. In turbulent times you may find that lenders prioritise the available security. In more buoyant times, security may become less important if you have a strong track record of profitable trading.

Who is the borrower?

The borrower will usually be either the business itself or the Employee Trust that owns the business.

The main benefit of the business being the borrower is that the interest and similar costs can usually be treated as a cost when calculating the business' corporation tax liabilities. It also insulates the trust from any risk.

If the Trust is the borrower, this has the benefit of the debt not usually being on the business' balance sheet. For the bank, the risk position should be the same in each case as it will usually take security over the business' assets, even if the loan sits with the Employee Trust.



Factors to keep in mind:

Good housekeeping:

Make sure that you have good financial systems and practices. This is not just to produce the figures that the bank will want to see when considering whether to make a loan, but for any ongoing financial reporting that the bank may require.

Ensure you have a robust business plan, as most lenders will expect this and it will ensure that you appear credible.

Shop around:

Try and engage with more than one lender. There is usually scope for negotiation around some of the commercial terms in any loan. Having more than one lender interested will usually strengthen your position.

Consider taking advice:

There are advisers who will support you in raising finance and negotiating terms with the lender.

Be clear about what you need:

As highlighted above, be clear on your needs when determining if you want to borrow and the nature of finance that you need.

Review the documents carefully:

Make sure that you review all the terms of the documents. In particular:

- For any term loan, the bank will usually seek to agree certain financial covenants with you that must be met throughout the term of the loan. You need to be comfortable with these and they can sometimes be negotiated.
- Be clear on and agree how early repayment will work, as there can be significant penalties. If this is something you want to have available to you, address it as part of the negotiation with the lender.
- Be clear on all the costs involved. Borrowing usually means paying interest, arrangement fees and often the lender's costs (such as legal costs). Agree these in advance.
- Bank documents will often prohibit or limit payments to other material creditors or the powers of those creditors in certain circumstances. If you are funding the exit of former owners, you need to be clear if this will impact these arrangements.

Baxendale are specialist advisers on employee ownership. We have been advising businesses on employee ownership for almost twenty years and have been employee owned ourselves for thirty years. During this time we have helped over 100 businesses become employee owned.

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