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The undercapitalised business

Many small businesses in New Zealand are undercapitalised, lacking sufficient capital to run efficiently. There are various reasons for this, but the consequences are similar. Chief amongst these are:

- Frequent cashflow challenges and a lack of working capital to meet bills and regular commitments.
- The struggle to find funds to invest in the necessary equipment, staff and resources required to expand the business.

This guide looks at some of the sources of business funding and what type of business is likely to attract funding.

Types of funding available

The most common types of funding available for business development and growth can be summarised as follows:

Personal equity, friends and family

Most businesses are funded by the owner's own equity (capital). The most common sources of small business equity are the owner's savings and/or a loan or mortgage raised against the owner's home. Further financing is often raised from friends and family.

Personal equity can also include the cashflow or savings you have built up in your business. This is the most cost-effective funding available, but takes a long period of time to build up.

Bank finance

The second most common source of funding for business development is your Bank. This funding can take various forms, such as short-term funding (for instance an overdraft) to meet immediate commitments, or longer-term funding for capital items (such as expensive machinery or buildings). Your Business Banking Manager will be able advise you on the correct balance between short-term and long-term finance, and to help you structure your bank borrowings in the most effective way. The Bank will want some form of security from you for any borrowings and will require regular repayments.

For more information on sourcing money from your Bank on the National Bank Solution Guide, [Applying for business finance](#).

Developing the right kind of business

You are more likely to attract funding for your business from all types of lenders if you have the following:

- A solid business plan that has been regularly updated. See the related National Bank Solution Guide: [How to write a simple business plan](#) for more details.
- Good business systems in place with a proven track record of achievement.
- A strong team with a spread of experience, strong management skills and good business skills. It's not enough to have a good idea, you must also have the people in place to make the idea work. There are more good business ideas around than there are capable teams.
- Positive business ratios (see the related National Bank Solution Guide: [Checking the health of your business](#) for more details). The key accounting ratios for your business need to be favourable in order for you to get funding.
- Clear competitive advantages. You need to spell out your key points of difference or your unique selling point. Are people really impressed by what you've developed? Do a wide variety of business people (not just close friends) share this feeling?
- Competitive barriers in place. Are your ideas or products protected by patents, trademarks, advanced technology, or other barriers likely to deter or delay the competition?
- Thorough market research. Many businesses fail to attract funds because the business owner(s) have not done enough market research.
- Sufficient demand and a sustainable market. Is your potential market big enough? Does your business have high growth potential? Are you operating in a mature industry or an emerging industry? Don't bother to approach venture capitalists unless your product or service has international appeal - the New Zealand market is too small to interest them.
- Evidence of forward planning to keep ahead of the field. Detail your strategy for second-generation products or services to replace or complement what you already have.

Government assistance

Your business may qualify for some government funding, or for assistance to develop business plans and other documentation required to gain funding for expansion. Most of the funding available comes in the form of grants whereby New Zealand Trade & Enterprise will reimburse 50% of the costs of employing consultants to develop the required information. To find out more information on these grants and various funding sources, and to determine if your business qualifies, phone 0800 555 888 or browse the [New Zealand Trade & Enterprise](#) website for more information, relevant publications and application forms.

Other finance sources

Other sources of finance for businesses include leasing arrangements entered into for items such as cars or machinery. The related National Bank Solution Guide, [Should I own or lease?](#) will help clarify your options. Speak to your Business Banking Manager before accepting any leasing arrangements proposed by a vendor: there may be more cost-effective finance options available to you. Alternative finance sources include:

Angel investors

Angel investors are people prepared to invest in a promising business venture, often at a relatively early stage. For example, a typical angel investor might be an experienced businessperson with spare investment funds who is looking around for a promising investment opportunity. Angel investors fill an important gap by operating in smaller investments (in New Zealand typically up to \$1,000,000, but normally less than this).

Angel investors usually invest in industries with which they are familiar. They expect at least a 30% return on their money and often want some equity (ownership) in your business to offset their risk.

Angel investors usually invest for a period of up to 6 years, at which time the business should be at a stage where refinancing is possible.

Venture capitalists

Venture capitalists are investment companies or fund managers that provide cash in return for part-ownership of your business. They are typically not interested in investments of less than \$1,000,000 because of the time and cost involved in checking out a business and the finance deal (due diligence). Their requirements are typically much tougher than angel investors. They tend to favour only high-growth companies that are likely to provide them with at least a 30% to 50% return per annum on their investment.

Venture capitalists will typically want to play an active role in the management of your business and add value through contributing business skills, their business networks and alliances, or their experience of successfully marketing products or services. They usually want to exit a business after the high-growth phase (typically within three to five years) so they can re-invest elsewhere, and will want you to detail an exit strategy in your business plan showing how they can do this profitably. The most common exit for most venture capital funded companies is a buy-out of their equity position by another company (known as a 'trade sale').

Are you prepared to share ownership?

There is no point in wasting your time approaching either angel investors or venture capitalists unless you are prepared to give up some ownership in your business. Remember, though, that it's better to own 40% of a business worth \$2,000,000 than 100% of a business worth \$150,000.

How to find investors

To find investors, try:

- Asking your Business Banking Manager.
- Asking your accountant or lawyer.
- Visiting www.bizangels.co.nz or www.angelassociation.co.nz for more information on angel investors.
- Visiting the www.vcapital.com website for information on venture capital funding.
- Enquiring through your business networks and organisations you belong to, such as the Employers' and Manufacturers' Association or Chamber of Commerce (www.chamber.co.nz) or your industry group.

Asking your local Economic Development Agency (see www.edanz.org.nz for details).

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