**How to grow your business with cash flow finance**

Are you familiar with the term ‘cash flow finance’?

If so, you may have heard that it can be a great way to support or grow a small business.

But do you know enough about it to decide if it’s right for your business – or how to pursue it if you think it will work for you?

If not, you’ve come to the right place.

In this article we’ll look at the different types of cash flow finance and how you could use it to keep your cash flow steady – or even take your business to the next level.

First, things first:

**What is cash flow finance?**

Yep, before we go any further, let’s talk about what exactly cash flow finance actually is.

**In a nutshell, cash flow finance is a way of funding your business that’s backed by your expected cash flow rather than by assets.**

So if you get a cash flow loan, you will be financing your current operations based on the money you (and your lender) believe you will receive in the future.

Cash flow finance is generally a short-term arrangement.

So when might you use it?

C**ommon uses for cash flow financing:**

There are a number of reasons why you might be thinking about using cash flow finance for your business.

Here are some great examples:

* **To prepare for seasonal peaks and troughs**

If your business is highly seasonal, you might need an injection of cash upfront in order to prepare for a seasonal peak (so you can buy in extra stock or take on extra staff in time to train them up). Or you may need help to make it through your slower times.

* **To buy new equipment or inventory**

Sometimes, demand for your products or services may increase. This is great, of course – but to meet the extra demand you may need to buy new equipment or additional stock. Cash flow financing can be a handy way to fund it, because you can use the money you’ll earn from the increased sales to pay back the loan.

* **To pursue an exciting opportunity**

The business world can move very fast, and you may be offered an opportunity with a very short window in which to commit. To take advantage you need money now. Cash flow finance could give you the funding you need, if you’re confident that the opportunity will eventually pay for itself.

* **To hire more people**

Maybe your company is expanding faster than you anticipated, or you need people to fill roles that will lead to more and more growth. Great news!

But of course you’ll need to pay these people. If you don’t yet have the money to cover their wages, cash flow financing could help you cover the costs until you start generating those extra profits.

* **To expand an online business into a bricks-and-mortar store (– or vice versa)**

If taking your business multi-channel is your goal, you may need to rent and fit out a new store or office, or set up a first-class website and e-commerce suite. Cash flow finance can help you to move into your physical or online channel, so you can start to generate those extra sales.

* **To expand in other ways**

You might also need funds to grow in other ways – like moving to a second location or adding a new product or service to your line. Cash flow finance could give you the resources you need to fund that growth.

**A word of warning**

Using cash flow financing can be risky. You are relying on EXPECTED future income – but what happens if you don’t generate the extra profits you are relying on?

That’s why it’s really important to get advice from your accountant or independent financial advisor before you apply for any form of cash flow finance.

Now know what cash flow finance is and how you could use it.

It’s time to get specific.

**What types of cash flow loans are there?**

In this section I’ll give you a handy overview of the different types of cash flow finance.

1. **Unsecured business loan**

You can use an unsecured business loan for any purpose, including any of the reasons I’ve covered above.

With an unsecured loan you’ll borrow a specific amount and then pay it back in monthly or weekly instalments, making fixed payments until you pay it off.

Your interest will probably be calculated with a factor rate, which is a multiple of the amount you borrow (e.g. 1.15%). You’ll pay the same amount regardless of how quickly you pay back the loan (so you won’t make any savings by making extra payments, but you also won’t face any early repayment penalties if you no longer want the loan).

**Is your business eligible?**

As long as you’ve been in business for six months or more, there’s a good chance you’ll qualify for an unsecured business loan. Even if you have a poor credit rating, there are lots of lenders in Australia’s alternative finance market who may be willing to offer you a loan to shore up your working capital.

**Is an unsecured business loan right for your business?**

If you’re after cash in a hurry, you may be able to get unsecured business loan in less than 48 hours. Unsecured business loans are very popular with business owners like you, because they’re easy to understand and easy to access.

Watch out though – the interest you pay can be high (especially if yours is a high-risk business), and you may have to provide a personal guarantee of the loan, which could put your home or other assets at risk.

1. **Business credit card**

Most small businesses in Australia have business credit cards, even if they have no other form of debt. A business credit card is a flexible form of short-term finance which is ideal for financing shortfalls in cash flow.

It’s also a simple and convenient way to cover your general business expenses. It can also be very economical *as long as you pay off your full balance each month.*

Be careful – if you find you can’t pay off your balance, that valuable interest-free period can quickly turn into compounding interest at very high rates.

**How could a business credit card be good for your business?**

* Having a credit card makes it super easy to buy from retail or online suppliers, so you’ll have no trouble keeping your office stocked, booking travel etc.
* It’s a good way to start building credit as a business
* You may find it easy to get a credit card, even if you can’t access a business loan

There are lots of different types of business credit card. Some come with low interest rates and no annual fees. Others offer discounts, airline points or other rewards that *could* be valuable to your business, but can often be outweighed by extra fees.

1. **Credit line**

A line of credit is similar to a business credit card or an overdraft. You’ll have a credit limit and instant access to the funds you need, up to your agreed credit limit. Your credit line may be:

* Fixed – which means you can draw the funds in one or more tranches and then repay your loan by an agreed date.
* Revolving – which means you can draw the funds, repay them and redraw them as often as you like within the term of the facility.

The main difference between a credit line and a business credit card is the way your interest will be calculated.

In both cases, you’ll only pay interest on the amount you borrow, rather than the full value of the facility, and you will probably pay a fee to set up the facility (and possibly ongoing administration fees) .

With a credit card, you’ll usually have an interest-free period, after which you’ll have to repay the full balance. If you don’t repay the full amount each month, you’ll pay interest on the balance from the day you made each purchase.

With a line of credit, your interest will be calculated daily on the balance you’ve drawn, so the less funds you use, the less you’ll pay. Also, they usually have lower interest rates than business credit cards.

**Is a line of credit right for your business?**

You may find it harder to access a credit line than a business credit card, as might need an established relationship with a lender before they’ll be willing to offer you this type of finance.

If you do qualify and you opt for a revolving line of credit you’ll need strict financial discipline. It’s all too easy to get dependent on having extra cash on hand – but your lender could withdraw your credit line at any time, so it’s important that you only use it only to cover shortfalls in your working capital, rather than for longer-term purchases.

1. **Merchant cash advance**

If yours is a retail or hospitality business and you make regular sales via credit card or EFTPOS, you may be able to access a merchant cash advance. This can be an expensive form of finance, but offers one major advantage:

Your repayments will be directly matched to your income.

With a merchant cash advance, you’ll receive a lump sum loan and then repay it, usually in daily instalments as percentage of your credit card or EFTPOS sales.

You’ll start making repayments immediately, and may have anywhere between 90 days and 18 months to pay off the full amount. As with a small business loan, your interest may be calculated as a factor rate rather than an annual interest rate.

**Should you get a merchant cash advance?**

If yours business doesn’t yet have a solid credit history, but you can prove you have a steady cash inflow, a merchant cash advance might be a good option for you.

It won’t be a low-cost option though – you could pay up to $1.50 for every dollar that you borrow – so be sure to consider other options before opting for this type of cash flow finance.

1. **Invoice financing**

Invoice financing, also known as factoring, is the ultimate form of cash flow financing.

Why?

Because it lets you accelerate the cash you’ll receive from your customers. Unlike all the other forms of cash flow finance on this list, factoring doesn’t involve borrowing. Instead, you’ll sell your invoices (or accounts receivable) to a third party.

You’ll get a cash advance (usually of up to 90% of the invoice value) and the factoring company will then collect payment of the invoice from your customer. At that point they’ll deduct their fee and pay you the balance.

**Could invoice finance be right for your business?**

Invoice finance has a lot of advantages. Firstly, lenders will look at the creditworthiness of your customers, rather than your own financial history – so you may be able to access it even if you can’t get any other form of cash flow loan.

Using invoice finance means you can offer credit terms to customers – which can make your business more competitive – without having to worry about the long gap between paying your suppliers and getting payment for your services.

There are some pretty serious pitfalls to invoice finance though.

For one thing, you may end up locked in to an arrangement where you have to sell all your invoices during a specific period, or for a particular customer, whether or not you need the cash at that time. And if you opt for a ‘recourse’ factoring arrangement, you could end up having to buy back the invoice from the lender if your customer fails to pay.

One more note of warning – once you sell an invoice the factoring company will deal direct with your customer, and you’ll have no control over the way they communicate. If they use aggressive tactics they could do some serious damage to your customer relationships and your precious reputation.

**How to compare different forms of cash flow financing**

There are lots of things to consider when you’re choosing which type of cash flow financing is right for your business. You should ask yourself the following questions:

* How much money do I need?
* What will I use the money for?
* How quickly do I need it?
* How quickly do I think I can to repay it?
* Will I need a single sum or ongoing access to credit?
* How much will it cost me?

Answering that last question can be trickier than it might seem, because the interest is calculated in different ways on different types of loan ([APR vs factor rate](https://www.lend.com.au/factor-rate-apr-calculator) for example).

Even when you’re comparing loans of the same type, you can’t just look at the advertised rate, because there will almost certainly be other fees and charges involved. You’ll need to take all those into account when you calculate the [comparison rate](https://www.moneysmart.gov.au/borrowing-and-credit/home-loans/interest-rates/comparison-rates).

Okay, so now you know what kinds of financing is available to you.

What now?

The next step is to weigh the pros and cons of cash flow financing and decide if it’s a good option for your business.

**Pros of cash flow financing**

* If you don’t yet have good credit, you can still qualify for many forms of cash flow financing, especially invoice financing. So you may be able to access the funds you need to keep your cash flow healthy or grow your business, even if you don’t qualify for a traditional business loan.
* Cash flow finance is generally unsecured, so you won’t need to offer assets as collateral – a major benefit if your business doesn’t yet own any assets!
* Some cash flow finance options let you pay back your loan as a percentage of your revenue, rather than through fixed regular payments. This is great if your business is highly seasonal, as your payments will be directly tied to your cash flow.
* You won’t have to miss out on great opportunities just because you don’t have spare cash. Cash flow financing can allow you to place orders on new inventory, or to scale up and take on larger contracts or projects.
* You’ll have the backup you need to keep your business afloat if things get slow. This couldn’t be more important, since poor cash flow is the number one reason businesses fail. Even large successful businesses that are profitable on paper can be brought down by lack of cash.
* Most forms of cash flow financing are quick and easy to access. In most cases you’ll just have to fill in a simple online form without having to produce piles of complicated paperwork to support your application.
* You can get money quickly. Some lenders will give you an on-the-spot response to your application, and you could have the funds in your account within days or even hours.
* As long as you keep up with the repayments on your cash flow financing it will help you to start building or improving your business credit rating, which may open the door to future financing options.

Yep. There are some definite benefits to cash flow financing.

So what’s the downside?

**Cons of cash flow financing**

Of course, as with any type of business finance, there are some pitfalls.

* The interest rates on cash flow loans can be pretty high. Trying to cover your loan repayments could drive your business deeper into financial trouble.
* Exciting growth opportunities may not generate as much profit as you expect – or may take longer than expected to show a return. In the meantime, you’ll still have to finance your repayments, which could put a massive strain on your working capital, or even bring your business to its knees.
* Even if you no longer need your cash flow finance, you may find you can’t repay your loan early to save on interest, because of the way that your payments are structured.
* If money is gets tight and you have default on a loan payment you could do serious damage to your credit rating and business reputation.
* For some forms of cash flow finance, you may have to provide a personal guarantee. If your business is forced to default, you’ll be personally responsible for repaying the loan. You could end up losing everything.
* Some business owners see cash flow finance as a dangerous trap. They may have a point. It’s all too easy to become dependent on cash flow finance and very tempting to treat on-call cash as your own funds. You may decide it’s better to wait and fund your business growth out of profits, rather than rely on borrowing and throw those precious profits away on interest repayments.

**Conclusion**

Cash flow issues are the main reason businesses in Australia fail – so cash flow financing might just be the solution you need to keep your business solvent until your paper profits turn into cash in your bank.

Although there can be serious downsides, (especially the high interest rates), cash flow finance can be a great way to inject funds into your business when you need it most. That might be the boost you need to keep on track during the slow seasons – or take advantage of exciting opportunities to grow your business.

As with any decision about finance, you’ll need to consider your specific circumstances and get advice from your accountants or financial advisors.

*Have you used cash flow financing to support or grow your business? How did it work for you? Let us know!*