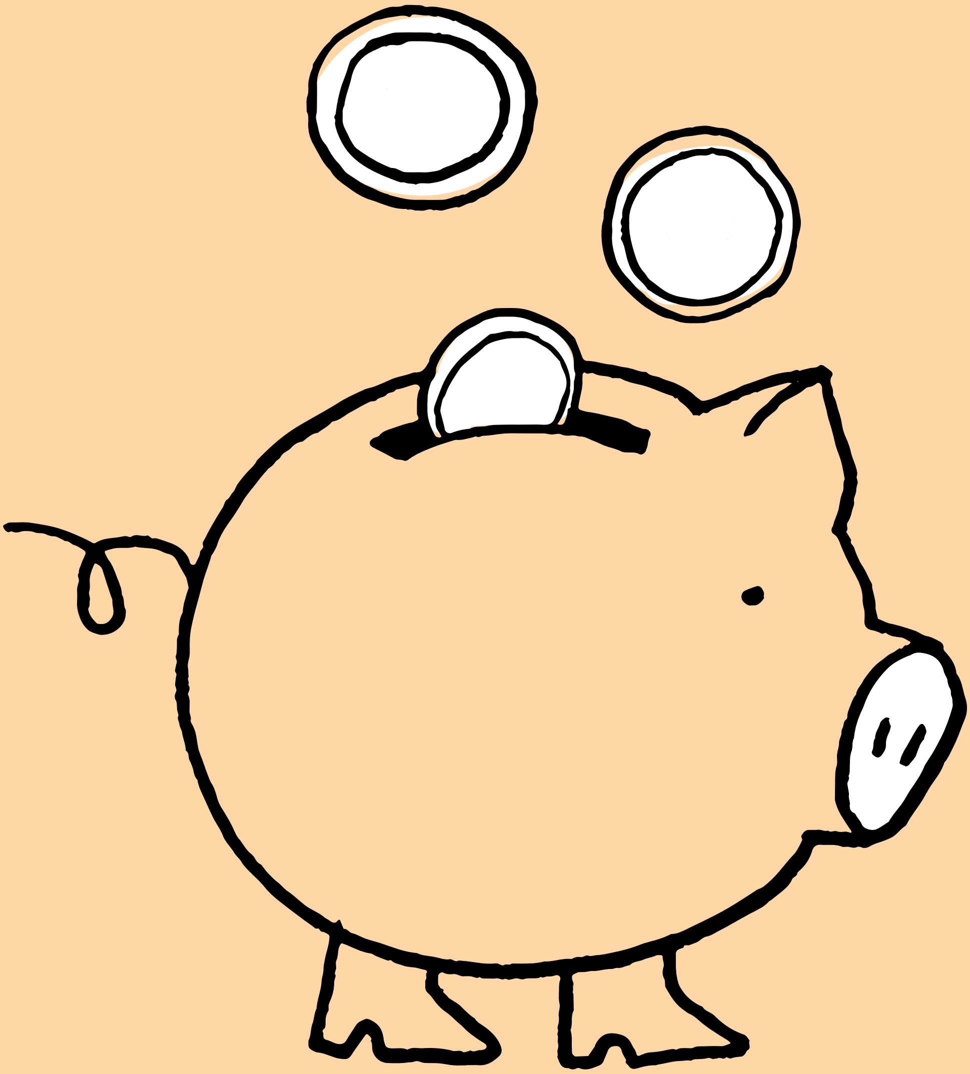
# 06 Financing

**How should you finance your business, and which documents will you need to present?**

This chapter explains the features of the various financing options available to business owners.

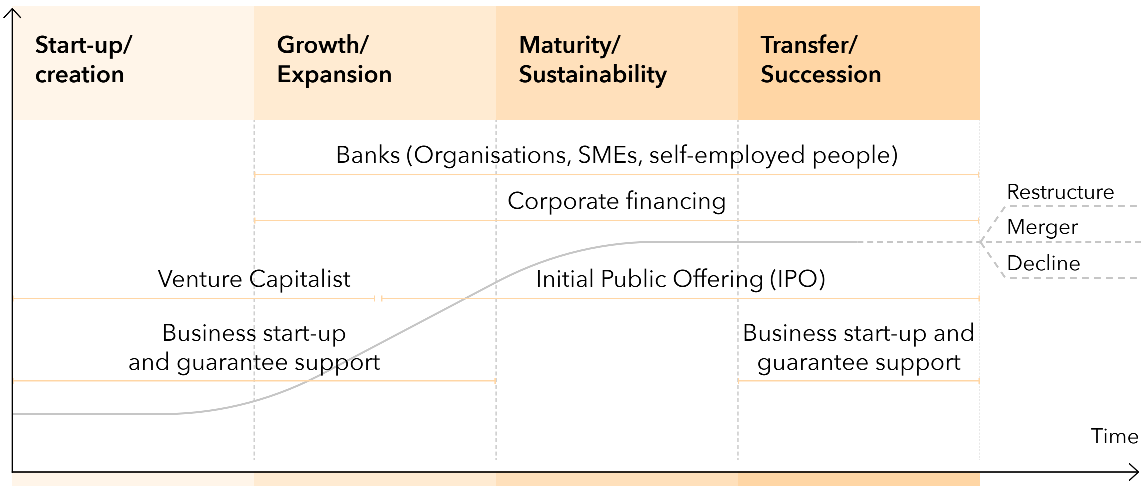


# Contents

# Types of financing

Starting and growing a business requires funds. A new business should primarily be financed by the owner's own funds.
However, external financing is often necessary, even essential, for a business to grow, whether it is an SA, Sàrl, cooperative, or if the owner is self-employed. These fund contributions come in many forms, and should be adapted based on the company's needs and stage of development.
A distinction should be made between capital financing and foreign funds (borrowing). While both aim to provide the capital that a company needs at a given moment, each type has its own logic and is suited to a different moment in the lifespan of a company.

## Company life cycles and financing[1]




| **Need for working capital** | **Need for working capital** | **Need for working capital** | **Needs** |
|---|---|---|---|
| **Credit limit**<br>Covered exclusively, namely by financial guarantee.<br>Indicative duration: 1 year<br>Amortisation: no, or according to guarantee | **Credit limit**<br>Indicative duration: 1 year<br>Amortisation: no | **Credit limit**<br>Indicative duration: 1 year<br>Amortisation: no | **Acquisition of minority shareholdings**<br>Indicative duration: 5/8 years |
| | **Fixed advance**<br>Indicative duration: 1/12 months<br>Amortisation: no | **Fixed advance**<br>Indicative duration: 1/12 months<br>Amortisation: no | **Mezzanine capital**<br>Indicative duration: 5/8 years |

[1] This table and a large part of this chapter are taken from the booklet '*Financement des entreprises : la doctrine d'engagement de la BCGE*' (Corporate financing: the BCGE liability doctrine), 2022. Extracts are indicated using footnotes.

| Investment | Investment | Investment | |
|---|---|---|---|
| **Fixed advance**<br>Covered exclusively, namely by financial guarantee<br>Indicative duration: 1/7 years<br>Amortisation: yes<br>**Leasing**<br>(vehicles and capital goods)<br>covered exclusively, namely by financial guarantee<br>Indicative duration: 1 to 5 years<br>Amortisation: yes | **Fixed advance**<br>Indicative duration: 1/7 years<br>Amortisation: yes<br>**Leasing**<br>(vehicles and capital goods)<br>Indicative duration: 1/5 years<br>Amortisation: yes<br>**Building loan**<br>Indicative duration: up to 18 months<br>Amortisation: yes<br>Business mortgage<br>Indicative duration: up to 33 years<br>Amortisation: yes | **Fixed advance**<br>Indicative duration: 1/7 years<br>Amortisation: yes<br>**Leasing**<br>(vehicles and capital goods)<br>Indicative duration: 1/5 years<br>Amortisation: yes<br>**Building loan**<br>Indicative duration: up to 18 months<br>Amortisation: yes<br>Business mortgage<br>Indicative duration: up to 33 years<br>Amortisation: yes | |
| **Other** | **Other** | **Other** | |
| **Bank guarantee**<br>Covered 100% by cash<br>Indicative duration: case by case basis<br>Amortisation: no | **Bank guarantee**<br>Indicative duration: case by case basis<br>Amortisation: no<br>**Documentary credit**<br>Indicative duration: case by case basis<br>Amortisation: no<br>**Acquisition of minority shareholdings**<br>Indicative duration: 5/8 years<br>Amortisation: no<br>**Mezzanine capital**<br>Indicative duration: 5/8 years<br>Amortisation: no | **Bank guarantee**<br>Indicative duration: case by case basis<br>Amortisation: no<br>**Documentary credit**<br>Indicative duration: case by case basis<br>Amortisation: no | |

| Possible guarantee |
|---|
| **Transfer or pledging of:** Liquidity, securities deposit, investment, stock, debtors, insurance, sale price<br>Bank guarantee |

## What is credit?

Generally speaking, credit refers to all lending activities. Applied to businesses, two main families can be identified:

- Operating loans, which make it possible to finance current assets (debtors, stock, ongoing work, etc.) that are not covered by working capital

- Investment loans, which are mainly used to finance fixed assets (technical equipment, production equipment, energy efficiency equipment, IT and telephones, vehicles, etc.), and the construction or purchase of buildings

## Credit vs private equity: two very different concepts

Credit should be differentiated from private equity. While both aim to provide the capital that a company needs at a given moment, they are suited to different times in the lifespan of a company (see table: Company life cycles).

Venture capitalists provide equity in the early development stages, for innovative companies or for technologies considered to have high potential for development and return on investment. Venture capital is essential for start-ups, as young developing businesses that very often experience temporary losses. This type of company has a maximum risk profile which does not fit the criteria of traditional bank financing.

Growth capital is essential to the company’s development and is necessary when the company has strong prospects for expansion, manifest in external growth or heavy investment in production tools, for example. Growth capital can also be used for operations on the company's capital (reclassifying securities, leverage buy out, management buyout, etc.).

Trade credit is backed by an investment or trade receivables. In this sense, the risk is limited to the possible loss of the pledged collateral. Growth capital is unsecured, backed solely by the company’s ability to survive and grow. As a result, the lines of credit, which include the actuarial risk of default, will vary significantly depending on the quality of the underlying asset – or the absence thereof, as with equity financing.

# 01. Permanent capital contribution

If business owners lack the funds necessary to support their project up to the operational phase, where they would have access to traditional financing (i.e. loans), they will need to turn to a partner who can make funds available. Invested capital is therefore the preferred form of financing for the initial phases of a business. This type of financing generally involves an entry into the company's capital, and therefore a sharing of “ownership” and decision-making power. The partner can be either a private investor (family, friends or third parties) or a specialist venture capital company. The partner's involvement can take different forms. The most common are:

- Direct subscription to company capital,
- Offering subordinated loans that act as equity, or
- Issuing convertible bonds.

To secure this type of financing, the future company will either need to find a partner interested in getting involved in the project, or a purely financial partnership. In the latter scenario, the investor generally commits sums of up to CHF 500,000, and will in principle seek to subsequently resell their shareholding for a financial gain.

This explains why companies that are likely to be financed need to meet certain characteristics, such as strong growth potential, clearly identified competitive advantages and a finalised business plan.

To find this type of investor, the business owner will mainly contact investment clubs (business angel clubs) in the region, such as:

- BAS – Business Angels Switzerland – businessangels.ch
- Go Beyond – gobeyondinvesting.com
- VERVE Ventures – verve.vc

For projects with very high potential, the company may also contact investment funds (venture capital). The sums invested will generally exceed millions of Swiss francs, but the company must meet strict criteria, such as having intellectual property, a consistent team and, above all, significant growth potential.

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**Advantages of invested capital**

- No debt or repayment
- Increase in equity and therefore improved financial security
- Possibility that the new shareholder brings their experience and skills to the company

### Disadvantages of invested capital

- Shared power (equity dilution)
- The founder's goals may diverge from those of the investor, which could cause internal disagreements
- It may be necessary to sell the company in the medium term

# 02. Short/medium/long term loans

In addition to its own funds, a company will need to resort to borrowing (short, medium and long term), cash advances, or even current account credit limits to finance itself. The need for these different types of credit will be felt at different times in the company's growth.

To ensure long-term growth by increasing equity, the company may also increase its capital (via existing shareholders or via new investments) or make an initial public offering (IPO). Banks will mainly be involved during the phases of expansion and, where applicable, transfer of the company. Financing needs therefore tend to concern the working capital requirement (WCR) or investment requirement.

## Financing the working capital requirement (WCR)

The working capital requirement results from discrepancies between disbursements and cash flow linked to the company's activity. To respond to this, different types of credit are available: current account credit, which allows the company to draw funds up to a fixed threshold in a given period in order to meet payments, or a straight loan (less than one year).

Working capital requirement in different business sectors:

### 1. Industry sector

| | |
|---|---|
| **High stock levels** | Long-term trade credit |
| | Miscellaneous net charges (incl. VAT and transitional liabilities such as contingency) |
| **Long-term accounts receivable** | Working capital requirement (WCR)* |

**Current account credit limit**

The industrial sector is characterised by a high WCR. Generally, inventories are high, customers pay within 180 days on average, and trade credit is substantial.

### 2. Service sector

| | |
|---|---|
| **Low stocks, shorter term** | Medium-term trade credit |
| **Long-term accounts receivable** | Miscellaneous net charges (incl. VAT) |
| | Working capital requirement |
| | **Current account credit limit** |

The services sector is characterised by relatively reduced inventories and fairly long payment times, both from customers and suppliers.

### 3. Retail sector

| | |
|---|---|
| **Average stocks** | Medium-value trade credit |
| **Very low accounts receivable, very short term** | |
| **Liquidity** | Miscellaneous net charges (incl. VAT) |

Retail trade has different features, since it generally generates a working capital resource. Customers generally pay quickly, while suppliers are paid after 30 days on average, which generates a different working capital structure.

### 4. Mass distribution sector

| | |
|---|---|
| **Average stocks** | Long-term trade credit |
| **Very low accounts receivable** | |
| **Liquidity** | Miscellaneous net charges (incl. VAT) |

The mass distribution sector is quite atypical because, even if stocks are high, turnover is particularly rapid. In addition, customers pay immediately, which also generates a working capital resource.[5]

[5] End of excerpt from the publication cited above.

## Financing the investment requirement

The investment requirement relates to long-lived fixed assets. It can be met in different ways. A fixed advance with a duration of more than one year is particularly suitable for financing medium-term investments. Investment requirements include acquiring commercial premises and buildings, which the company will be able to finance through a business mortgage. For building projects, the company may opt for a building loan: a short-term loan in the form of a current account which is debited as the work progresses, on the basis of invoice remittance. This loan is then consolidated by a facility agreement: the mortgage.

## Loan commitments

Finally, in the context of import and export activities, the company may require loan commitments: a bank guarantee, bond or documentary credit.

## The golden rules for granting a loan

To grant credit to a company, banks usually rely firstly on a qualitative approach based on their expertise, which is supported by a quantitative analysis.

The qualitative approach gives the bank an understanding of the company. First, the bank reviews the management team's professional skills, as these are of paramount importance: what experience do they have, where have they been successful, what shape has their career taken? The bank will look into many aspects. Next, it will analyse the business sector and any distinctive features. The company's customer base, strategy, market position and its competitive context are also analysed.

Although it is important for the bank to understand how the company and management team are intrinsically run, this information is not enough to precisely indicate the company's financial resources. This is where the quantitative approach comes in, designed to measure resources. The bank uses financial ratios particularly based on cash flow, turnover, profitability and equity. The most significant among these are explained below.

The bank also reviews the business plan and verifies the consistency of the assumptions made regarding the company's growth. Indeed, the company must be able to service its debt (interest and amortisation). To achieve this, it needs to create liquidity. The company's ability to honour its commitments is analysed based on its track record, which is also used to evaluate the company's evolution and draw future projections. When it comes to financing business growth, it is also necessary to consider forecasts, i.e. the increase in turnover made possible by the investment. It is important, however, not to lose sight of the fact that achieving projections also depends on economic fluctuations and changes in regulations.

# Main financial ratios

Financial ratios have been used to determine risk of default for over 50 years. What's more, internationally, 75% of loans issued contain an agreement related to one or more financial ratios.

The quantitative analysis by the bank is based on ratios, which are assessed according to the company's business sector and the resulting balance sheet structure. Using these indicators, the bank seeks to answer the following questions: what is the company's financial solidity? Is it profitable in the long term? If the resulting answer is positive, the bank will be able to provide assistance. The next question is, how much? The answer is given by assessing the company's ability to meet its costs.

**Ratio 1 – Company solidity assessment**
*equity/balance sheet total X 100*

This ratio measures the volume of equity capital and gives a first indication of the degree to which a company is self-financed. Assets are recorded at their net depreciation value. This ratio may vary greatly from one business sector to another, and will be assessed accordingly and/or by comparison with the standards of other similar companies.

**Ratio 2 – Financial equilibrium assessment, i.e. working capital**
*current assets/short-term debts*

By calculating working capital, the company's financial equilibrium can be verified. For the financial structure to be deemed healthy, the result of this calculation must be at least equal to zero, with current assets covering short-term debts. A working capital which occasionally falls below zero indicates an imbalance in finances. If the figure is frequently below zero, this signals a risk of insolvency.

**Ratio 3 – Company profitability assessment**
*EBIDTA/Turnover X 100*

EBITDA* is used to measure a company's profitability before interest, taxes and depreciation and provisions are deducted. Expressed as a percentage of turnover, EBITDA allows the profitability of different companies in the same business sector to be compared.

**Ratio 4 – Assessment of the company's ability to service its debt**
*EBITDA/Debt service*

Debt service refers to the amount that must be paid each year to service the debt (i.e. interest, amortisation and annuities due). This ratio enables the lender to define a minimum acceptable threshold. The higher the ratio, the easier it is to obtain financing. A ratio that is too low, generally X%, would usually indicate too much debt from the perspective of the company's self-financing capacity, since the company would have to direct too large a portion of its self-financing capacity towards servicing its debt.

*EBITDA (Earnings Before Interest Taxes, Depreciation and Amortisation)

### Ratio 5 – Assessment of a company's financial leverage
*Net financial debt / EBITDA*

This ratio uses the company's EBITDA to determine the number of years needed to repay its financial debts. Generally, depending on the activity, companies are considered to be able to cope with a ratio of 2× to 4×; beyond this, the leverage is considered too high and there is also a high risk of failure.

### Cash flow assessment

Cash flow indicates whether a company has the means to sustain itself. It is used in the company's self-financing capacity and to pay shareholders. Cash flow is a good indicator of a company's solvency and sustainability.

Table for determining cash flow

| Operating activities | Investment activities | Financing activities |
|---|---|---|
| **Net income** | **Acquisition of tangible and intangible assets** | **Capital increase** |
| + Allocations to depreciation and provisions<br>- Reversals of depreciation and provisions<br>- Capital gains (+ capital losses) from asset disposal<br>+/- variations in the working capital requirement | - Acquisition of financial assets<br>+ Proceeds from tangible and intangible asset disposals<br>+ Proceeds from financial asset disposals | - Dividends paid<br>+ Increase in financial debts<br>- Debt repayment |
| | **= Net cash flow linked to investment activities (B)** | **= Net operating cash flow generated by financing (C)** |
| **= Net operating cash flow generated by operating activities (A)** | **A+B= Free cash flow** | **A+B+C = Cash flow variation** |

It is crucial to understand the financial burden that a company can bear (debt capacity). The starting point is free cash flow. This is the cash flow that the company can freely dispose of by paying it out as profit or investing it as reserves for the company's expansion. In theory, free cash flow should be enough to repay commercial debts over 5 to 8 years.

# 03. Off-balance sheet (OBS) financing

Leasing, lease-purchasing and renting capital goods are not forms of traditional financing. They make it possible to use capital goods by mobilising a minimum of capital without burdening the balance sheet.

It should be noted that this is not for purchased but rented goods. As with property, the object in question remains the property of the leasing company until its possible repurchase, which may occur at the end of the contract, depending on each individual case. This method is particularly suitable for fast-growing businesses that are already using their credit capacity.

# 04. Summary table

| Needs | Solutions | Usual duration | Type of financing | Sectors concerned Features | Interlocutors |
|---|---|---|---|---|---|
| **Lack of equity** | Equity contribution<br>Permanent capital contribution | Indefinite | Capital increase<br>Acquisition of holdings<br>Subordinated loan<br>Convertible loan | All sectors | Venture capital company<br>Private investors |
| | | Maximum 5 years | Equity participation | Job-creating SMEs | Fondation d'aide aux entreprises (FAE) |
| **Property purchase** | Provision of repayable capital | Maximum 50 years | Business mortgage | All sectors | Banks<br>Insurance |
| **Capital good purchase** | Provision of repayable capital | Maximum 10 years<br>1 to 5 years | Guaranteed loan | Industry, job-creating SMEs; trade<br>and craft; domiciled in the canton of Geneva | Fondation d'aide aux entreprises (FAE)<br>Fondetec |
| | | | Investment loan | All sectors | Banks |
| | | | Leasing | Vehicles, machines | Leasing companies; Banks |

| | | | | | |
|---|---|---|---|---|---|
| **Current cash flow** | Limit available in current account | 1 year, renewable | Guaranteed loan | All sectors | Banks |
| | | | | | Banks<br>Insurance |
| | | | Operating loan | | Banks<br>Insurance |
| | | A few months | Seasonal loan | | |
| **Provision of a rent deposit** | Bond issuance | According to lease | Guarantee | All sectors | Banks |

# 05. Other financing methods

Crowdfunding makes it possible to collect funds from private individuals in order to finance projects. Project leaders can use crowdfunding to pre-sell products and services, obtain loans, open up capital or receive donations.

For business creators, pre-sale is one of the clearest forms of crowdfunding. Beyond financing the project, it allows creators to gauge customer interest in a concept. Confirmed interest through community commitment also makes it possible to co-develop the project with customers, who become strongly involved in its success through pre-ordering the product or service.

From a financial point of view, pre-sale also enables funds to be built up. This approach can also avoid the need for a bank loan, and maximise chances of obtaining credit. The success of a crowdfunding campaign is the best guarantee that a bank can expect, unlike a market study, which is very hypothetical in nature.

Equity investment platforms can also be useful for business creators hoping to find new shareholders to raise funds. These are generally aimed at projects that are further along with a track record for their concept. Such projects may have already carried out a pre-sale campaign, and have company shareholders who accept equity dilution.

Crowdfunding offers businesses many benefits, but it is not an easy form of financing. Before launching a campaign, there are four important aspects to consider:

- The first is the likelihood of attracting a community to contribute to the project. Crowdfunding platforms facilitate access to international communities, but business creators need to be able to communicate well and persuade them to give their support.
- The second aspect is the trust regarding the project's success and ability to deliver it. When communities are further away geographically, it is always more difficult to create this trust.
- The third aspect is the cause being campaigned, the values it represents, and the quality of the project.

- The fourth aspect is the one given in exchange for pre-orders. Given that it involves a more or less significant risk, it is essential that the cause and values are inspiring enough to convince communities to support the project.

Crowdfunding is growing fast, particularly with the use of blockchain, which strengthens trust, decentralisation and exchanges.

For more information on this financing method, visit the following links:

- kmu.admin.ch

- finma.ch

# 06. Financing support

Over the years, different organisations have been set up to facilitate access to financing for businesses. The services offered differ from one organisation to the next, but in terms of their approaches and philosophy, they tend to be very similar.

While the analytical criteria are similar to those used by banks, these organisations have a higher risk tolerance, mainly because the potential impact of the company on the intervention zone is taken into account, especially in terms of job creation.

Services offered by organisations for financing support include:

- Bond: This is an agreement whereby a guarantor makes a commitment with a bank (or leasing institution) to guarantee the credit taken out by the company. It is therefore not directly a loan, but a guarantee given to a lending institution that the credit (or leasing) balance will be repaid in place of the debtor, if the latter were to default. With a guarantee, it is easier for businesses to secure financing. Visit the Fondation d'aide aux entreprises (FAE) (fae-ge.ch) or the Cautionnement Romand (represented by the FAE in the canton of Geneva).

- Direct loans: mainly offered by Fondetec (fondetec.ch).

- Factoring – see FAE.

- Acquisition of minority shareholdings: offered very selectively and under strict conditions by the FAE.

# Useful addresses

## Banque Cantonale de Genève

Quai de l'Ile 17 | 1204 Genève
Tél. 058 211 21 00 | bcge.ch/entreprises

## FAE – Fondation d'Aide aux Entreprises

(Business Assistance Foundation)

Route de la Galaise 34 | 1228 Plan-les-Ouates
Tél. 022 827 42 84 | fae-ge.ch

## FONDETEC – Fondation communale pour le développement des emplois et du tissu économique en Ville de Genève

Boulevard James-Fazy 8 | 1201 Genève
Tél. 022 519 63 31 | fondetec.ch

## VENTURE KICK

EPFL innovation Park | Bâtiment C | 1015 Genève
Tél. 021 533 09 82 | venturekick.ch

## Office cantonal de l'économie et de l'innovation (OCEI)

(Cantonal Office for Economy and Innovation (OCEI))

Rue de l'Hôtel-de-Ville 11 | Case postale 3216 | 1211 Genève 3
Tél. 022 388 34 34 | innovation.ge.ch