Basic Finance and Legal Requirements

Getting money to start a business is hard at the best of times, but there are a number of sources of help, which range from central government initiatives to self-help schemes. Refugees in business will need to know about these. They will also need to be familiar with the basics of business in the UK, including legal requirements.

This section describes
- → Mainstream sources of finance
- → Alternative sources of finance
- → The basics of running a business in the UK
- → Legal requirements
- → Why businesses fail
- → If it all goes wrong

Getting Finance

It is not easy for any new business to raise finance. New businesses are one of the biggest risks for any lender as almost two-thirds of them go bankrupt in the first three years of trading.

All lenders will require a comprehensive business plan, and they may want you to send this into them prior to any meeting. It is usual for them to question clients very deeply about the plan and its contents, and therefore the client must be familiar and knowledgeable about every detail. Banks will generally not lend money on ventures that they consider risky, and a detailed business plan provides them with assurance that this is not the case.

Banks are usually the first place businesses approach for loans, and often they may want some form of security/guarantees against the loan. However, clients must realise that banks are also businesses! They have a duty to return profits to their shareholders.

Most banks will require the client to put in some funds of their own as 'matched funding', i.e. you put in £5,000, they put in £5,000 – they want to see that you have confidence in your idea. However, there are schemes which are government supported i.e. The Small Firms Loans Guarantee Scheme (SFLGS). These are designed for people with no assets, and the government guarantees up to 75 – 85 per cent (there are regional variations) of the loan. The bank's risk is, therefore, limited to the remaining 15 –25 per cent. All the major banks in the UK are eligible for the scheme, and they are the first contact point. However, certain types of businesses are not eligible for these loans (Eligibility exceptions are available on the SFLGS page on the Department of Trade and Industry (DTI) Web pages).

The Prince's Trust may be able to help with loans for those businesses owned by 18 -31 year old entrepreneurs. There are various other avenues that may be a source of finance, however, many of these are specific to geographic areas, i.e. Development Agencies, Regeneration programmes, etc. The business adviser is the best person to access these.

In addition, there are venture capital companies and Business Angels who will take equity in the business in return for the risk investment. However, these are usually not suitable for new start businesses unless these are very hi-tech and innovative. There are other ways of receiving finance, but these involve costs and are really only applicable to businesses which have a trading record.

Grants and sponsorship

The local Business Link can run 'searches' for any grants. The grant search is usually European, which means that the UK is included, plus any possible funding from European sources, i.e. European Social Fund.

Grants often tend to be industry-specific or related to regeneration areas. However, the grant process is long and very complicated. Most Business Links should have specialist grant advisers who work with clients to access the documentation needed and the processes involved to try to obtain a grant.

Alternative Sources of Finance

Syndicates

Another method of finance is to join a syndicate. This has become a common practice amongst refugees. Several people come together and pool their money in the syndicate. Every member at set times, usually every month, will put in a certain amount. Then each member will take it in turns to use the full amount. Some people may use a syndicate for religious reasons, as there is no system of interest involved. Others may not be fully aware of the banking system and may have been used to this system in their country of origin.

The key advantage is the availability of a large sum of money, especially for those using the money at the beginning of the arrangement. However, there are issues of trust that involve an element of risk - who will take responsibility for collecting the money each set period? An RCO may be able to provide assistance with setting up a syndicate and providing the ground rules for good practice.

Co-operatives

Refugees may be interested in setting up a business as a co-operative. RCO advisers should be aware of this option. A co-operative is a group of people who run the business together and who have an equal say and usually an equal financial share in it.[1] Co-operatives are part of an international movement that tries to base itself on a set of values and principles, which the International Co-operative Alliance (ICA) sets out as including democracy, participation, voluntary, educational and co-operation with others also including self-help, self-responsibility, equality and equity.[2] This means that members have come together with a common set of values and make these the basis of their business. A co-operative is owned and democratically controlled by its members therefore business decisions are supposed to balance profitability against the needs of members and the interests of the wider community.[3]

There are many different types of co-operative and there is no set formula for how they are run, making them flexible, applicable to any business activity, and potentially innovative. The most common model is a consumer co-operative where ownership is based on membership, rather than shares, and profits are distributed as lower prices and improved services. Other types include credit unions, which can provide credit for people who cannot access commercial banks or financial institutions and worker co-operatives, which are owned solely by the employees. One problem that has been identified with co-operatives is their inability to grow and expand due to the constraints of ensuring a democratic workplace.[4]

Social Enterprises

Refugees may also be interested in setting up social enterprises. These use business methods to deliver social goals. Typically their surpluses (rather than profits) are reinvested in social or environmental goals. The scope for activity is unlimited but includes earning additional money for voluntary or community organisations, or bringing niche products to the market place. There are many available structures for social enterprises including a Community Interest Company, a company structure specifically designed for social enterprises. Refugee clients should be made aware of this form of operating if it appears they are mixing business methods with community goals. It may even be of interest to Refugee Community Organisations themselves.

Business Basics

The UK Banking System

Refugees often face particular difficulties working within the UK banking system. Banks require firm evidence of identity and this may be difficult for refugees with no track record in the UK, who have been accommodated by NASS and have no previous address, or are unable to provide collateral, or a reference. Refugees may need help to establish their identity and place of residence. Most banks have lists of acceptable documentation required to prove this, and it may help to discuss these with a bank manager. Some refugees may need explanations of the conventions of making and receiving payments, such as cheques, direct debits and standing orders. For detailed help with banking queries it may be useful to approach your RCO's bank manager, or a business adviser.

Using an Accountant

It is often a complicated and daunting task for a small business to produce a proper set of accounts, deal with everyday paperwork and meet the relevant tax deadlines and regulations. To keep on top of this side of the business, many businesses employ an accountant. He or she can provide a range of vital services such as producing a profit and loss account, manage payroll systems, carry out pricing policy reviews or advise on the most effective accounting methods. Even in the early stages of a business, an accountant may be able to help with deciding on financial viability or drawing up business plans.

If the business has a large enough turnover or projected turnover, it may need to plan an audit after the first year of operation. For audits, a qualified accountant who is a member of one of the institutes of chartered accountants is required to go through the business's books and agree them; however accounting technicians may also be an option. As an accountant will be managing a business' statutory obligations, a clear and trusting relationship is essential.

A business adviser will be able to provide clients with basic help on accounting and have access to all the necessary information, which can also be offered by the Federation of Small Businesses (FSB) or certain trade and professional associations. Given the amount of information that a refugee may have to digest to enable them to start up a business, as an RCO adviser, you may find it helpful to suggest accountants to deal with this part of setting up. Before seeing any accountant, it is a good idea to prepare a list of questions; while some may grant an initial 30 minutes free of charge, other time will be charged at current rates, which are expensive.

Legal Requirements

Income Tax

As a sole trader or partnership, business owners are classed as self-employed and must assess their own tax, paying it to the HMRC (Her Majesty's Revenue and Customs) by the appropriate deadlines, 31st January and 31st July, each year. A sole trader is taxed on the profit made by their business, whereas in a partnership, each partner is taxed on the portion of profit they take. Profit is defined as the amount left of a business' income after deducting material costs, overheads, employees' wages, business expenses and sometimes capital allowances. If the business employs staff then it must deduct National Insurance (NI) and income tax, and pay these monthly to HMRC under the Pay as You Earn (PAYE) scheme.

Corporation Tax

Private limited companies are liable for corporation tax and the directors are classed as employees, paying tax under the PAYE scheme. This tax starts usually with profits over £10,000 and the rate of tax then increases in bands of profit increase. The company can also pay its shareholders a share of the profits known as dividends.

National Insurance (NI)

National Insurance is a contribution towards state benefits, which includes retirement pension, unemployment and incapacity benefits. A business employing staff must deduct these under the PAYE scheme and send in monthly contributions. This applies to directors of private limited companies. But those who are self-employed follow a separate structure. As the amounts may differ significantly, it is worth considering before a decision is made over whether a business should be set up as a sole trader, limited company or partnership.

Value Added Tax (VAT)

VAT is the tax levied on most sales, services and imports. If a business's turnover is more than £60,000, it becomes a 'taxable person' and must register with the HMRC. The business must then charge VAT on products and services as output tax, charged at three rates: standard (17.5%), reduced (5%) and zero-rated (0%). But a business is also able to then claim back VAT as input tax on the goods and services it has bought. In this respect, some businesses may want to register as a "taxable person" voluntarily to gain this benefit, though this needs to be weighed against the costs of calculating and processing such claims.

There is also a scheme whereby a business can pay a lower rate of VAT if it does not claim VAT back on purchases. This can be very quick to calculate, and can provide a cash benefit to the business if it is not likely to purchase much by way of VAT-able goods in its trading period.

Health and Safety

Under the Management of Health and Safety at Work Regulations 1999, all businesses must assess the health and safety risks within the workplace. The owner, director or employee can carry out this assessment covering all work activities and their associated hazards, even non-physical dangers such as workplace stress. Alternatively, a health and safety consultant can be appointed.

Guidance notes on all aspects of health and safety are available from the Health and Safety Executive.[5] Evaluating any potential dangers should lead to:

- Removing or reducing the risk
- Providing adequate information and training for staff involved
- Ensuring the risk complies with the relevant legislation and good practice standards
- Providing welfare provision
- In the last instance, providing protective equipment.

A health and safety policy and record of this risk assessment must be kept by any business employing five or more staff. Filling in a risk assessment form each year is usually the simplest method. This is also obtainable from the Health and Safety Executive. Legislation and requirements become more complex as more staff are employed, so businesses need to be aware of all the relevant regulations.

In addition, food businesses must comply with food hygiene laws, which apply to anyone who handles food on a commercial basis, including primary producers such as farmers. New legislation was brought in January 2006, details of which can be found in the Food Standards Agency ‘Safer Food, Better Business’ pack.[6]

Data Protection Act and Freedom of Information Act

The Data Protection Act provides the legal basis for the privacy and protection of data of citizens and businesses. These state that data disclosed by one party to another may only be used for the specific purposes it was disclosed for and can only be kept for an appropriate length of time. This means that data cannot be shared with other parties without the data owner’s consent. Further, individuals have certain rights to find out what information an organisation holds about them and ensure it is accurate. This is important legislation that a business should be aware of when dealing with customers and staff.

The Freedom of Information Act gives individuals rights to request information from public authorities. This may be of use for businesses when coming into contact with public bodies[7], such as through inspections or undertaking contracts for the public sector.

Employing People

There are many issues to consider when employing people, and a range of legislation safeguarding employee rights. Some of this has already been covered under Income Tax, National Insurance and Health and Safety. A business must keep up to date with other areas, including the resolution of disputes, grievance procedures, maternity and parental rights, rights for fixed-term employees, holiday entitlement, sick pay, equal opportunities and redundancy. In this respect, small businesses should take time to think about exactly what staff and skills they need.

In addition, having an effective personnel policy is important in contributing to good management of staff, which is vital to the success of a business. To start with, recruiting staff involves a set of procedures that take account of appropriate job descriptions, person specifications, competitive salary levels and interviews based on fair selection, often in line with an equal opportunities policy. Job offers, whether verbal or written, constitute a contract and a written statement of the main terms of employment must be provided within two months of employment. Once an employee starts work, procedures should be in place to ensure a good induction programme (introduction to the requirements of the workplace, the business, the job and the people) and that training needs are assessed at regular appraisals.

It is becoming more common for staff to be put on Probationary Contracts for periods of three to six months in order to avoid costly confrontations at a later date if the staff prove to be unsuitable. This works both ways, in that staff can more easily be dismissed within this period, but they also can leave of their own accord if they are not happy in the position.

Insurance

Insurance can be important, in particular for small businesses, for protection against threats to profitability. There are certain types of insurance that are legally required. Vehicles must have motor insurance, and if members of the public come into the premises, e.g. a shop or restaurant etc, then Public Liability Insurance must be in place, as well as premises and content insurance. Once a business employs staff or a limited company is set up (limited companies must have this), employer's liability insurance must be taken out to cover all injuries and illnesses related to an employer's duties and work activities. Minimum cover must be £5 million and a certificate must be displayed in the place of business, which can be inspected by health and safety. Businesses, not limited companies, employing direct family members, are exempt, as are companies with the owner as the sole employee. Any business using vehicles must take out motor insurance with third party liability and include business use. Drivers' licences must be checked and any employee using their own car should have a policy that covers business use.

It is also good practice to insure against other risks. Common ones include buildings insurance, content insurance, business equipment, business interruption (protects against any losses and extra costs caused by serious disruption), public liability (cover for any damages to public or property as a result of business activities), professional indemnity (cover against being sued for poor advice or negligence) and product liability (type of public liability covering claims related to a business' products).

Other types of insurance to consider are legal insurance (covers commercial legal expenses), personal liability (covers the director of a company), key person insurance (covers losses relating to the loss of a key employee), income protection (for self-employed), credit insurance (protects against debtors going bankrupt), employee litigation insurance (covers against claims brought by employees) and home workers' insurance. As with any insurance decision, time should be taken to review each available policy; authorised insurers can be verified through the Financial Services Authority[8] or the services of an insurance broker or consultant can be enlisted.

Why Businesses Fail

The main reason why most businesses fail is through lack of 'working capital' – the money needed to run the business on a daily basis. This is especially true for businesses that are selling to other businesses, (referred to as a Business to Business or B2B market). Many suppliers will not give accounts on credit straight away to new businesses; therefore the company has to pay them first, in full, for the products, which means having the money up front. When products are sold, the company will have to wait at least 30 days for payment (statistics show this is actually more likely to be 60 - 70 days). This means that for three or four months a business will have no income from that sale, yet must still pay all the expenses, salary and overheads, plus continuing to buy more products.

Working capital also relates to another problem, which is bad cash flow, when a business does not have enough money in the bank to pay its bills and salaries. This usually occurs because of lack of working capital. Businesses tend to overestimate their sales and underestimate how long it will actually take to get paid.

In addition, businesses fail because they have not done their research properly. Many are 'product-led', i.e. they have thought of an idea and go with it, whereas today's successful businesses are 'market-led', they do their research and establish whether there is a need and demand for the product/service before they begin. It is then important to establish a correct price for entry into that market.

The methods of promotion are also critical. Money is wasted on promotions that never reach the potential client because of lack of knowledge of the target market and the ways to reach it effectively and efficiently.

The skills of the owner are another factor. Many owners of small businesses may have skills related to their business sector, but they need management skills as well to control finance, budgets, marketing, and personnel.

If It All Goes Wrong

Not everything in business goes according to plan. If a business fails, there are a number of courses of action open to the entrepreneur. These include speaking to a bank manager, or going to the local Citizens' Advice Bureau or debt counselling service. There can be considerable trepidation about these processes, so here we have simply described the last option.

Bankruptcy

Bankruptcy is only one debt management procedure, which must be distinguished from other methods such as administration, receivership and liquidation. It is viewed as a last option. Once a business has reached a point of having insufficient assets to meet all its debts, then it has become insolvent. Bankruptcy is a legal procedure that will allow these debts to be paid by the sale of the business or owner's assets. In this way it terminates all trading operations and dissolves the legal entity that was conducting these operations. This is started when a bankruptcy petition is submitted either by the business's creditors or the debtor.

What are the advantages and disadvantages of becoming bankrupt?

Bankruptcy will 'wipe the slate clean' and allow someone to start again, while sharing assets fairly amongst creditors. However, the current business will be lost, the owner's personal possessions may be seized (unless he or she is a director of a limited company or member of a limited partnership) and their ability to obtain credit in future may be seriously affected. This will restrict future business activities. Until all the debts are settled, the debtor remains an undischarged bankrupt, is subject to official investigations and placed under certain financial restrictions. Generally, a debtor will be discharged one year after the date of the bankruptcy order; however the official receiver can apply for this to be postponed. Once discharged, the debtor will be released from most of the debts (except those arising from fraud, personal injury claims or non-provable debts) and most financial and business restrictions.

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[1] www.cooperatives-uk.coop/live/cme507.htm
[2] *New Internationalist 368*, June 2004
[3] www.ica.coop/coop/index.html
[4] *New Internationalist 368*, June 2004.
[5] www.hse.gov.uk
[6] www.food.gov.uk
[7] Full list of bodies included available from www.dca.gov.uk
[8] Enquiry line 08456061234 or website www.fsa.gov.uk