

How to choose the right business loan

Choosing the right business loan can be a stressful and daunting experience. Different products, confusing terminology and varying interest rates can make it difficult to know where to begin.

Figuring out how to cut through the reams of information to get to the heart of what is actually relevant will help you narrow down the search and ultimately find the right loan for your business.

Business loan, business finance or alternative finance?

We often use business loans as a catch-all term, but is that what we really mean? Bear in mind from the outset that financing your business doesn't necessarily mean going to your bank and asking for a loan.

Today's marketplace offers huge variety across both the traditional and the alternative finance sectors. This means business finance is more flexible now than it ever was.

It could be that invoice finance or asset finance offer a much more suitable solution for your needs. Or you might prefer revolving credit facilities, top-up facilities, and overdraft-style options. Approach your search with an open mind, and you just might find the perfect business finance for your situation.

Understanding business loan interest rates

Let's face it, interest rates are probably what you'll look at first. It's tempting to base your decision on the headline rate, but this rarely offers a true like-for-like comparison, unless all other features of available loans are the same. Is the quoted rate an APR or a monthly rate, for example? What is the term? Does it include setup fees? Will you be charged extra for repaying early?

An easier and more relevant way to compare interest is to use a business loan calculator. You can calculate how much interest is being charged in total, what the monthly repayments will be, and what is most affordable for you.

I often talk about "total cost of finance" because it really is the simplest way to lay it all on the table and make a decision. For example, a higher rate may work out cheaper in total over a shorter term, but you may be willing to pay a bit more overall in exchange for a longer term. It could be that even though the overall cost of the loan is less, higher monthly repayments rule it out as an option.

Do you need security?

Although there is much more flexibility available in today's business finance market, there will be factors that restrict you from having a certain type of finance over another, and security can be one of them.

Business loans are either secured or unsecured. Secured loans take tangible assets such as commercial property, machinery or vehicles as security. This is often required where your

business is new or presents a riskier proposition to a lender, and the amount you can borrow is generally determined by the value of the assets.

Unsecured loans, on the other hand, tend to be based on the financial strength of your business, and lenders will look at factors like annual turnover, profit margins, and consistency over the long-term. If you are eligible for an unsecured loan, you may be asked to provide a personal guarantee, but you may also be able to borrow more and get hold of the cash faster, so there's no right or wrong answer here — it depends on your situation and personal preference.

Other points to consider

There are many other factors which could help narrow down the search, such as how much flexibility you need, how soon you need the money and how long you want to borrow it for. If you need a pot of cash available to dip into as and when required rather than a lump sum sat in the bank, then choosing a revolving credit facility would be your best option.

If cash flow is the issue, products like merchant cash advances and invoice finance could offer a better solution. Equally, if you want to buy a piece of machinery or a vehicle, then asset finance could be the answer. And finally, if you need the money quickly, there are products that will get the funding into your account within hours — but this speed often comes at a price.

Conclusion

There are a lot of funding options open to you now, many of which are even tailored to what you need the money for. This means you should be able to find something that is well suited to your business and its requirements.

Finding the best product can seem like a bit of a minefield to begin with, but by asking the right questions and making the right comparisons, you can start narrowing down the search.

Conrad Ford is Chief Executive of Funding Options, recently described by the Telegraph as “the matchmaking website for small businesses and lenders”. Funding Options has been selected by HM Treasury to help businesses find finance when they're unsuccessful with the major banks, as part of the Bank Referral Scheme that launched in November 2016.