Overdrafts and bank loans

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An overdraft is predominantly for short-term needs, although it is possible to renew this over several years, and to increase or reduce it according to the business needs.

It is expected that at some point the business's account would get into credit as well as debit.

If you want to finance purchase of assets or property or perhaps refurbishment, then a bank would point you towards a loan.

An overdraft has now fixed payments, so it is essentially a revolving credit facility. The account will move from credit to debit. The amount of interest is charged on a daily basis, and the limit is usually agreed on up to a 12-month period. It's generally more short-term than a loan facility. And the interest charged is typically related to a margin (e.g. 5%) above base rate.

A loan is normally over a longer period. The way a loan account normally works is that you would borrow the full amount requested, with the first repayment beginning typically one month after being drawn down.

In most cases there is no difference in the level of security required between an overdraft or loan, and in many case it is possible to get borrowing fro ma bank without providing security. Banks will tend to look at this after they've assesses affordability. If they do require security, they will usually look at the assets owned by he business for example property or stock or trade debtors.

Covenants are terms and conditions that form part of the loan agreement, and place some sort of obligation on the business borrower. In many cases, especially for small amounts, there are no covenants at all. If covenants are required, they are usually around things like loan to valuation ratios. In addition to interest payments, both overdrafts and loans typically attract an arrangement fee, typically a percentage of the total facility.

The difference between banks an alternative providers (not high street banks), is very little. The basic premise of the loan is common to both types of provider. The main different will be in the terms and conditions, amount of interest paid and perhaps repayment terms – but these will always be unique to the offer that each provider is able to make.

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