

7 chapter

Financing Business Project

**Introduction to Business
DBB 1213**

Instructor Lecture PowerPoints

Business and Finance

- ***In order to start and grow a business, the business need to be financed using money.***
- ***Three ways to finance small business: self, debt, and equity financing.***





How Entrepreneurs Finance Their Business?

***Self
Financing***

***Debt
Financing***

***Equity
Financing***



Self Financing

- Self-financing means using your own money, savings or earnings to grow your company.
- While it's great way to maintain profits, it is often not an option for a small business owner.
- This is because they need a large amount of money to open up a business.



Sources of Self Financing

Where does money for self financing comes from?

Money for self financing can be obtained from the following sources:

1. Own money or savings
2. Profit earned from the business



Debt Financing

- The process of raising capital through borrowing of money
- Sources of debt financing are more than sources of equity financing, but the entrepreneur must be certain the business can generate enough cash flow to repay the loan.
- They must also pay the interest amount charged to the loan borrowed.

Sources of Debt Financing

Where does money for debt financing comes from?

Money for debt financing can be borrowed from the following sources:

1. Friends
2. Family
3. Banks
4. Lending institutions



Sources of Debt Financing (Banks)

Banks were once the primary source of borrowing, but today they are much more conservative in their lending practices.

Banks rely on the five Cs to determine the acceptability of a business loan applicant:

Character

Capacity

Capitol

Conditions

Collateral



Sources of Debt Financing (Banks)

1. A bank must believe in the **character** of the entrepreneur,

Character: a borrower's reputation for fair and ethical practices, including business experience, dealings with other businesses, and reputation in the community

2. Banks consider the **capacity** of a business to pay its debts

Capacity: the ability of a business to pay a loan in view of its income and obligations

Sources of Debt Financing (Banks)

3. Banks place a strong emphasis on whether a business has a financially stable **capital** structure.

Capital: the net worth of a business, the amount by which its assets exceed its liabilities

4. Banks consider all the **conditions** in which the business operates.

Conditions: the circumstances at the time of the loan request, including potential for growth, amount of competition, location, form of ownership, and insurance



Sources of Debt Financing (Banks)

5. Banks are more likely to lend to businesses with valuable **collateral**.

Collateral: security in the form of assets that a company pledges to a lender



Collateral for Debt Financing

The following assets can be used as collateral for debt financing:

- i. Savings
- ii. Land or buildings
- iii. Machinery or equipment
- iv. Accounts receivable
- v. Guarantor (a family / friend who is able and willing to pay off the loan if you are unable to)



Equity Financing

- The process of raising capital through the sale of shares of your company
- In equity financing, the owner must give equity to obtain the capital.
- Equity: an ownership in a business



Equity Financing

- With equity financing, you're searching for investors to buy part of the company while still remaining a partial owner.
- Unlike a business loan where you must pay back the balance with interest, the shareholder gets share of the profits in form of dividend and typically the voting rights associated.

Sources of Equity Financing

Where does money for equity financing comes from?

Money for equity financing can be obtained from the following sources:

1. Business angels
2. Selling of ordinary shares
3. Selling of preference shares





Sources of Equity Financing (Business Angels)

- Business angels are individuals who invest their personal money directly in start-up business.
- Usually business angel is about 50 years old, has high income and wealth, is well educated, has succeeded as an entrepreneur, and is interested in the startup process.
- These investors generally invest between \$10,000 - \$500,000 in a single company and are looking for companies that have the potential to grow between 30% to 40% per year.

Sources of Equity Financing

(Ordinary and Preference Shares)

Ordinary Shares

- They are known as equity shares
- Shareholders of these shares are the owners of the company
- Shareholders have got voting rights, one share one vote
- These shares have greater risk
- Owners of these shares receive dividend after preference dividend has been paid
- Ordinary dividend is not fixed, it varies with the availability of profit ie more profits more dividend, no profits no dividend

Preference Shares

- They are not owners of the company
- Preference shareholders have no voting rights
- The shareholders receive a fixed rate of dividend.
- The rate of dividend is given before the word Preference shares
- In the event of liquidation they are paid their capital before ordinary shareholders
- They are less risk



Debt Financing VS Equity Financing

1. Control of your business

If a business owner is willing to give up control, then an equity investor is a good option.

But if a business owner would not consider letting someone else make a business decision for them, a lender is a better option.



Debt Financing VS Equity Financing

2. Growth

How much growth of your company you are looking for determine whether debt financing or equity financing will be better.

Investors typically look for companies with the plan (and potential) to grow big, in order to get profit from their investment.

But if your plan is to grow a small but sustainable business instead, a lender might be a better option.



Debt Financing VS Equity Financing

3. Timing

Debt financing can be fast. A lender can often have a decision back to you quickly.

In equity financing, finding the right equity investor will take more time.

Internal and External Financing

	Internal Financing	External Financing
Types	Self financing	Debt financing and Equity financing
Meaning	The money is generated within the business	The money is generated from outside of business
Application	Used when requirement of funding is limited	Used when requirement of funding is big
Collateral	No collateral required	Collateral is required (especially with debt financing)