Lecture #6

### **Financing a Startup Company**

#### **1. Understanding Capital**

**What is Capital?**

* Capital refers to the assets or cash required to start or grow a business. It can be in the form of money or other resources owned by a person or organization.
* Capital is essential for starting a company or making investments because it provides the financial foundation to achieve business goals and deliver services.

**Why is Capital Needed?**

* **To Start the Business:** Before earning any revenue, a company needs to invest in setting up operations. This includes purchasing assets, securing office space, and acquiring necessary equipment.
* **To Operate the Business:** Capital is used to cover ongoing expenses such as salaries, rent, equipment maintenance, marketing costs, and other miscellaneous expenses.
* **To Provide Services:** Often, customers will pay for services only after they have been delivered. Initially, the company must use its capital to fund these services before receiving payment from clients.

#### **2. Why Cash is Important**

**Cash Needs:**

* **Salaries:** To pay employees for their work.
* **Rent:** To secure an office or workspace.
* **Equipment:** To purchase or maintain necessary tools and technology.
* **Marketing:** To promote the business and attract customers.
* **Miscellaneous Expenses:** Covering other unexpected or small costs that arise.

#### **3. What is a Business Plan?**

**Business Plan Overview:**

* A business plan is a detailed document that outlines what a company will do, the market it aims to serve, and the financial projections for the business.

**What Should a Business Plan Contain?**

* **Description of the Business:** What the company will be doing.
* **Market Description:** The target market and an estimate of its size.
* **Competition Assessment:** An analysis of competitors in the market.
* **Financial Predictions:** A forecast of the company's financial performance, including budgets, cash flow predictions, projected balance sheets, and profit and loss accounts.

#### **4. Sources of Finance**

**1. Grants:**

* Grants are funds provided by governments, organizations, or institutions to support businesses without the need to repay. They are often given based on specific criteria like innovation, research, or community impact.

**2. Loans:**

* **Definition:** Loans involve borrowing money from a lender (like a bank) with the agreement to repay it over time with interest.
* **Personal Guarantees:** If the business does not have sufficient assets, the lender may ask for personal guarantees, meaning the business owner personally guarantees the repayment of the loan.
* **Liquidation:** In case the business fails and goes into liquidation, the lender can recover the loan by selling the company's assets.

**Liquidation** is the process of closing a business and turning its assets (like property, equipment, or inventory) into cash to pay off its debts. Once the debts are paid, any remaining money is given to the business owners or shareholders. After liquidation, the business stops operating.

* **Overdraft Loans**An overdraft loan lets a company take out more money than it has in its bank account. But the bank can stop this at any time. If the company depends on this money and the bank stops it, the company could have serious money problems.
* **Long-term Loans**A long-term loan is borrowed for a set number of years, with a fixed interest rate. As long as the company pays interest on time, the lender cannot ask for the money back early. The company pays the full loan back at the end of the loan term.
* **Soft Loans**Soft loans have low interest rates and are often given to new or small businesses. These loans are usually offered by governments to help small businesses grow and succeed.
* **Corporate Bonds**Corporate bonds are loans that companies take from investors to raise money. Investors buy these bonds, and the company promises to pay back the money with interest after a set time.
* **Soft Loans – Government Help**Governments sometimes give soft loans with low interest rates to help new or small businesses. This is part of their plan to help businesses grow and create more jobs.

**3. Equity Capital:**

* **Definition:** Equity capital refers to the money invested by the owners or shareholders of a company. In return for their investment, they receive a share of ownership in the company. Unlike loans, equity capital does not need to be repaid.

Example of Equity Capital:

If you start a business and invest $50,000 of your own money, that $50,000 is your equity capital. If a friend invests $50,000 as well, they now own half of the business. If the business makes a profit, you and your friend share the profits based on your ownership. If the business doesn't do well, neither of you gets your money back, but there’s no loan to repay.

**4. Gearing and Leverage:**

* **Gearing:** Gearing is the ratio of a company’s debt to its equity (own money). It shows how much the company relies on borrowed money to run or grow its business

Gearing shows how much money a company borrows compared to its own money. If a company borrows a lot, it’s called "high gearing." This can be risky because the company still has to pay back the loans even if it’s not making enough profit.

* **Leverage:** Leverage refers to the use of borrowed funds to increase the potential return on investment. High leverage means more debt is used to finance the business, which can amplify profits but also increases risk.

Example of Leverage:

If you invest $10,000 of your own money in a business and borrow $20,000 more, you have $30,000 to work with. If the business makes a profit, your earnings could be much higher because of the borrowed money. But if the business loses money, you still have to pay back the loan, which increases your risk.