Introduction to Entrepreneurship and Innovation

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CHAPTER 10

Financing or Funding Your New Venture

Read more: Difference between Funding and Financing | Difference Between http://www.differencebetween.net/business/difference-between-funding-and-financing/#ixzz6seUekaM4

Financing vs funding

Funding

- Funding is an amount of money provided by an organization or government on the basis of an agreement.
- It is usually free of charge.
- There may be certain contractual requirements in that agreement, but there are no requirements to pay back the capital.
- The most common facilitators that normally fulfill the funding needs of a start-up are the donations made by governments, or philanthropists.

Financing

- Financing, on the other hand, is an amount of capital or the sum of money provided to a start-up with the expectation to repay
- A start-up is liable to pay back the capital amount along with a certain percentage of interest.
- Therefore, the repayment also includes an interest component.
- It is usually provided by financial institutions like banks, or investors like venture capitalists, business angels, shareholders, etc.

Importance of getting financing or funding

Few people think about or deal with the process of raising investment capital until they really need it.

Many entrepreneurs go about the task of **raising capital haphazardly** because they lack experience in this area and because they don't know much about their choices.

The need to raise money **surprises** a number of entrepreneurs who launch their firms with the intention of funding all their needs internally. Commonly, though, *entrepreneurs discover that operating without investment capital or borrowed money is more difficult than they anticipated.*

Why Most New Ventures Need Funding

There are three reasons that most entrepreneurial ventures need to raise money during their early life:

1. **cash flow challenges:**
   - Inventory must be purchased,
   - Employees must be trained and paid,
   - Advertising must be paid for before cash is generated from sales.

2. **capital investments:**
   - The cost of buying real estate,
   - Building facilities,
   - purchasing equipment typically exceeds a firm's ability to provide funds for these needs on its own.

3. **lengthy product development cycles:**
   - Some products are under development for years before they generate earnings.
   - The up-front costs often exceed a firm's ability to fund these activities on its own.

Examples are Important

Burn rate

Company's **burn rate:**

is the rate at which it is spending its capital until it reaches profitability.

- A negative cash flow can cause severe complications. *A firm usually fails if it burns through all its capital before it becomes profitable.*
- This is why *inadequate financial resources is a primary reason new firms fail*
- A firm can simply run out of money *even if it has good products and satisfied customers.*

For example, it typically takes between one and a half and two years to develop an electronic game.

Alternatives for Raising Money for a New Venture

https://www.yout-ube.com/watch?v=36nvyMw_3z4

1. **Personal funds**
2. **Debt or Equity Financing**
3. **Creative Sources**

Important link

1. Sources of Personal Financing

Personal Funds

- The vast majority of founders contribute personal funds, along with sweat equity, to their ventures.

- ***Sweat equity*** represents the value of the time and effort that a founder puts into a new venture. Because many founders do not have a substantial amount of cash to put into their ventures, it is often the sweat equity that makes the most difference.

1. Sources of Personal Financing… cont.

Friends and Family

- Often comes in the form of loans or investments, but can also involve outright gifts, foregone or delayed compensation, or reduced or free rent.

- There are three rules of thumb that entrepreneurs should follow when asking friends and family members for money:
  1. First, the request should be presented in a businesslike manner. The potential of the business along with the **risks** involved should be carefully and **fully described**.
  2. Second, if the help the entrepreneur receives is in the form of a loan, a promissory note should be prepared, with a repayment schedule, and the note should be signed by both parties.
  3. Third, financial help should be requested only from those who are in a legitimate position to offer assistance. It's not a good idea to ask certain friends or family members, regardless of how much they may have expressed a willingness to help, for assistance if losing the money would cripple them financially.

"to pull oneself up by one's bootstraps"

1. Sources of Personal Financing… cont.

Bootstrapping

It is the term attached to the general philosophy of **minimizing** start-up **expenses** by aggressively pursuing cost-cutting techniques and money-saving tactics.

Bootstrapping is finding ways to avoid the need for external financing or funding through creativity, ingenuity, thriftiness, cost cutting, or any means necessary.

There are subtle downsides: Cost-cutting and saving money are admirable practices, but pushing these practices too far can hold a business back from reaching its full potential.

Examples of Bootstrapping Methods

- Buy used instead of new equipment
- Coordinate purchases with other businesses
- Lease equipment instead of buying
- Obtain payments in advance from customers
- Minimize personal expenses
- Avoid unnecessary expenses, such as lavish office space or furniture
- Buy items cheaply, but prudently, through discount outlets or online auctions such as eBay, rather than at full-price stores
- Share office space or employees with other businesses
- Hire interns