How do you finance your business

⇒ There are two basic ways of funding your business.

→ The first is to grow your business organically. (boot strapping)

{This model works well for consultancy and service businesses}

→ The second way of funding your business is to bring cash into the business, either through the sale of equity, taking on of debts or by winning awards and grants.

{This model is more common where there is likely to be a developmental period before product can be sold.}

★ Cash flow

⇒ Rule number one in running a business is never run out of cash.

⇒ Reducing the time between incurring costs and receipt of revenue is important to maintain cash flow.

5.2> **Sources of finance**

⇒ The three basic source of funds for startup businesses are:

- → Winning a grant
- → Taking on of debt
- → Sale of equity.

→ Grants are in some ways free money.

- → does not need to be repaid
- → does not reduce your ownership of your company.
- → Term & Condition will be there.

→ They all generally require repayment and the payment of interest.

→ The basic principle being that you sell some of the equity of your company to an investor.

→ If company fails, the investor looses their money.

★ Grants

⇒ Governments are allowed to offer companies working in recognised deprived areas, financial and practical assistance in order to stimulate the creation of employment.

⇒ Some grants are available to single organisations
↳ Other require groups of companies to work collaboratively, either with other companies or Universities.

⇒ Grant may pay 50% towards a project's cost. This means that the company will have to match this funding and spend its own money to provide the remaining 50%.

⇒ Using grants to bring funding into your business has many advantages.

⇒ The disadvantages of grants are that often the application process is time consuming and can take many months to achieve, years in some cases.

Benefits:
- → forming valuable collaborations
- → Providing prestige & publicity for the business.
- → Investors think your ideas are worth funding.

★ Debt

⇒ The simplest form of debt is a loan.

↳ Loans can be provided by anyone from a friend to a bank.

⇒ In all cases, the fundamental components of the loan are that you have to repay the capital, the amount you borrow.

↳ In addition compensate the lender for depriving them of their money for that period of time.

⇒ Banks require some sort of security on the loan.

⇒ Benifits of debt mode of finance:

- → No day to day interference in your company from the lender.

⇒ The main disadvantage of debt however is that, in times of difficulty, lenders such as bank are more intrested in their capital than the continuation of the business and will not hesitate to close the business if they see a risk of losing their capital.

⇒ Debt is most approprite tool in managing cash flow.

★ Equity

⇒ Equity funding is the process of selling a share of your company to raise money that the company uses to grow.

⇒ In most cases the money is not repaid and if the company fails the investor loses their investment.

⇒ All the companies are required to maintain a register of shareholders and notify the company registration authorities of the list.

⇒ Depending on the amount of investment you require, there are many potential groups of equity investors.

Business Angels

- Businessperson who has made money and is looking to invest it in a small company that they can get involved with and even work in on a part time basis.
- Source of expertise as well as cash.

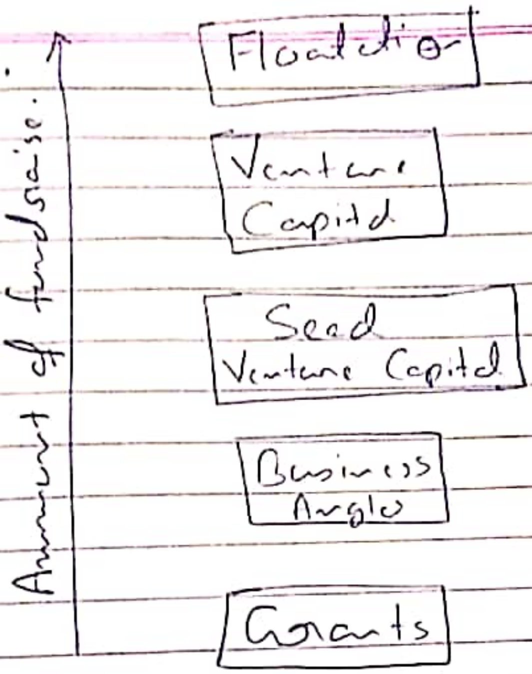
Venture capital

- They are professionally run organisations that invest in high growth potential businesses in order to make a capital return.
- They often specialise in their investments
  - By Size of Investment.
  - By Industry sector.

Stock exchange

- Offer part of the equity of your company to the public and allow those shares to be traded freely.

5.



⇒ Advantages of Equity Investment:

- → No capital or interest repayment.
- → Add value in terms of expertise, experience and contacts.

5.3) How does venture capital work?

⇒ The VC firm builds a fund by essentially selling shares in it to these customers with the promise to repay them with high rate of return when the fund closes in say ten years.

⇒ Having built a fund, the VC firm then looks for companies to invest the money in that will provide enough capital growth to make good on their promises and take their fee.

⇒ At the end of the VC fund life capital need to be extracted from the investment, so that funds can be repaid to the customers.

↳ EXIT Strategy

★ What are Venture Capitalists looking for?

- Committed and competent management team.
- They look for business plan that is understandable and realistic.
- Opportunities that are different and unique but that has potential.
- Within management team they want to see vision and enthusiasm tempered by experience & capability.
- Most of the money will be put by VC but they, like to see management team are also investing something too.
- The business proposition needs to be clear and understandable.
- The investment need to be appropriate for the VC firm
  - In their area of expertise.
  - Of right scale.
- Market need to be growing.

★ How do they structure a deal

⇒ It is relatively rare for VC firm to buy ordinary shares in a company.

- Since they are investing a vast majority of fund, such an approach will dilute the existing shareholder and management almost out of existence.
- They spread these investment across number of share types and even loan.

★ How do you value your company

⇒ If you have a trading business that last year made profit of $100,000, then a simple valuation method is to compare that profit to interest that you could receive from a saving account.

↳ If interest rate is 5% then your valuation is $2m.

⇒ Another way to look at this outcome is that the value is equal to 20 times the profit.

↳ The multiplier is called price earnings or PE ratio.

⇒ If you are not yet in the position of making profits, but are forecasting to do so in the future then there are other methods you can apply.

↳ It is called Net Present Value Calculation.

★ Exit Strategies

⇒ There are three basic exit strategy available:

- ↳ Trade sale to Large Company.
- ↳ Buy-Out {Sell your share in the next round of funding}
- ↳ Stock - Market