

Sources of Financing

Financing is needed to start a business and ramp it up to profitability. There are several sources to consider when looking for start-up financing. But first you need to consider how much money you need and when you will need it. The financial needs of a business will vary according to the type and size of the business. For example, processing businesses are usually capital intensive, requiring large amounts of capital. Retail businesses usually require less capital. Debt and equity are the two major sources of financing. Government grants to finance certain aspects of a business may be an option. Also, incentives may be available to locate in certain communities and/or encourage activities in particular industries. This time we will focus on equity financing which means exchanging a portion of the ownership of the business for a financial investment in the business. The ownership stake resulting from an equity investment allows the investor to share in the company's profits. Equity involves a permanent investment in a company and is not repaid by the company at a later date. The investment should be properly defined in a formally created business entity. An equity stake in a company can be in the form of membership units, as in the case of a limited liability company or in the form of common or preferred stock as in a corporation. Companies may establish different classes of stock to control voting rights among shareholders. Similarly, companies may use different types of preferred stock. For example, common stockholders can vote while preferred stockholders generally cannot. But common stockholders are last in line for the company's assets in case of default or bankruptcy. Preferred stockholders receive a predetermined dividend before common stockholders receive a dividend.

Personal Savings

The first place to look for money is your own savings or equity. Personal resources can include profit-sharing or early retirement funds, real estate equity loans, or cash value insurance policies. A standard feature of many life insurance policies is the owner's ability to borrow against the cash value of the policy. The money can be used for business needs. It takes about two years for a policy to accumulate sufficient cash value for borrowing. You may borrow most of the cash value of the policy. The loan will reduce the face value of the policy and, in the case of death, the loan has to be repaid before the beneficiaries of the policy receive any payment. A home equity loan is a loan backed by the value of the equity in your home. If your home is paid for, it can be used to generate funds from the entire value of your home. If your home has an existing mortgage, it can provide funds on the difference between the value of the house and the unpaid mortgage amount. For example, if your house is worth \$150,000 with an outstanding mortgage of \$60,000, you have \$90,000 in equity you can use as collateral for a home equity loan or line of credit. Some home equity loans are set up as a revolving credit line from which you can draw the amount needed at any time. The interest on a home equity loan is tax deductible.

Venture Capital

Venture capital refers to financing that comes from companies or individuals in the business of investing in young, privately held businesses. They provide capital to young businesses in exchange for an ownership share of the business. Venture capital firms usually don't want to participate in the initial financing of a business unless the company has management with a proven track record. Generally, they prefer to invest in companies that have received significant equity investments from the founders and are already profitable. They also prefer businesses that have a competitive advantage or a strong value proposition in the form of a patent, a proven demand for the product, or a very special (and protectable) idea. Venture capital investors often take a hands-on approach to their investments, requiring representation on the board of directors and sometimes the hiring of managers. Venture capital investors can provide valuable guidance and business advice. However, they are looking for substantial returns on their investments and their objectives may be at cross purposes with those of the founders. They are often focused on short-term gain. Venture capital firms are usually focused on creating an investment portfolio of businesses with high-growth

potential resulting in high rates of returns. These businesses are often high-risk investments. They may look for annual returns of 25 to 30 percent on their overall investment portfolio. Because these are usually high-risk business investments, they want investments with expected returns of 50 percent or more. Assuming that some business investments will return 50 percent or more while others will fail, it is hoped that the overall portfolio will return 25 to 30 percent. More specifically, many venture capitalists subscribe to the 2-6-2 rule of thumb. This means that typically two investments will yield high returns, six will yield moderate returns (or just return their original investment), and two will fail.

Angel Investors

Angel investors are individuals and businesses that are interested in helping small businesses survive and grow. So their objective may be more than just focusing on economic returns. Although angel investors often have somewhat of a mission focus, they are still interested in profitability and security for their investment. So they may still make many of the same demands as a venture capitalist. Angel investors may be interested in the economic development of a specific geographic area in which they are located. Angel investors may focus on earlier stage financing and smaller financing amounts than venture capitalists.

Government Grants

Federal and state governments often have financial assistance in the form of grants and/or tax credits for start-up or expanding businesses.

Equity Offerings

In this situation, the business sells stock directly to the public. Depending on the circumstances, equity offerings can raise substantial amounts of funds. The structure of the offering can take many forms and requires careful oversight by the company's legal representative.

Initial Public Offerings

Initial Public Offerings (IPOs) are used when companies have profitable operations, management stability, and strong demand for their products or services. This generally doesn't happen until companies have been in business for several years. To get to this point, they usually will raise funds privately one or more times.

Warrants

Warrants are a special type of instrument used for long-term financing. They are useful for start-up companies to encourage investment by minimizing downside risk while providing upside potential. For example, warrants can be issued to management in a start-up company as part of the reimbursement package. A warrant is a security that grants the owner of the warrant the right to buy stock in the issuing company at a pre-determined (exercise) price at a future date (before a specified expiration date). Its value is the relationship of the market price of the stock to the purchase price (warrant price) of the stock. If the market price of the stock rises above the warrant price, the holder can exercise the warrant. This involves purchasing the stock at the warrant price. So, in this situation, the warrant provides the opportunity to purchase the stock at a price below current market price. If the current market price of the stock is below the warrant price, the warrant is worthless because exercising the warrant would be the same as buying the stock at a price higher than the current market price. So, the warrant is left to expire. Generally warrants contain a specific date at which they expire if not exercised by that date.

Ex. 1 Find the words or expressions in the text which mean the following:

- 1) a company at an early development stage: _____
- 2) to differ: _____
- 3) money owed to sb: _____
- 4) the value of the shares issued by a company: _____
- 5) ordinary shares: _____
- 6) not being able to pay your obligations: _____
- 7) money paid to shareholders as part of profit sharing: _____
- 8) somebody who has the right to receive money, for instance, from an insurance policy: _____
- 9) sth that secures a loan: _____
- 10) performance history: _____
- 11) being better than business rivals: _____
- 12) to have different objectives in mind: _____

Ex. 2 Match the expressions from the two columns into logical collocations:

- | | |
|-------------------|-------------------------------|
| 1) to ramp up | intensive business |
| 2) a capital | mortgage |
| 3) an ownership | equity loans |
| 4) real estate | a business into profitability |
| 5) to accumulate | of credit |
| 6) the face value | capital |
| 7) an outstanding | deductible |
| 8) a line | sufficient cash value |
| 9) a tax | stake in a business |
| 10) venture | of a policy |

Ex. 3 Provide English equivalents of these expressions:

1) portfel inwestycji	7) popyt
2) zwrot z inwestycji	8) wcześniej ustalone
3) niepisana zasada	9) zapadalność
4) zebrać fundusze	10) świadectwo udziałowe
5) nadzór	11) aktualna cena rynkowa
6) inwestor indywidualny	12) pakiet wynagrodzenia

Grammar corner...

Dependent prepositions - part 2. Some time ago you learned that there is a group of words in English that usually and customarily go with certain prepositions. The best way to learn them is to ... read a lot in English and remember, which is what we'll do today. Please remember, sometimes the preposition can change the meaning of the whole phrase, e.g. to look for sb, to look after sb, to look into sth all have different meanings, search, take care of, and investigate respectively.

Ex. 4 Fill in the sentences with the best dependent preposition. Try to first do it without looking back at the reading.

- 1) If you're looking _____ a long-term investment, this is a product for you.
- 2) According _____ the agreement, you will pay the shipping costs.
- 3) We must really focus _____ this project, or else we'll miss the deadline.
- 4) A currency dealer's job is to exchange large quantities of one currency _____ substantial sums of a different currency when the exchange rate is the most favourable.
- 5) Rising gas prices result _____ everything else becoming more expensive.
- 6) If you invest in a company, you're also entitled to a share _____ its potential profits.
- 7) One of the ways to raise capital is to borrow _____ the value of your home.

- 8) Some brands are so recognizable, that their logo itself has substantial equity _____ it.
- 9) Usually when you borrow money from a bank, there is an interest charged _____ the sum you loaned.
- 10) There's a high demand _____ this company's products, so they don't really need too much advertising.
- 11) There are several approaches _____ solving this problem, but I believe none is perfect.
- 12) I will loan you the money to start your business, but I expect some return _____ my investment.
- 13) If you are on the management board of a company that can't pay you yet, they may issue warrants _____ you as a non-cash form of your salary.

GLOSSARY	
to owe sb money	być komuś winnym pieniądze
an incentive	zachęta
voting rights	prawa do głosu (np. akcjonariuszy)
face value	wartość nominalna
respectively	odpowiednio
shipping	transport
substantial	znaczny, znaczący
favourable	korzystny
to vary	różnić się
equity	kapitał, wartość
common stock	akcje zwykłe
a default	niewywiązanie się ze zobowiązań
a beneficiary	beneficjent
a collateral	zastaw
a track record	historia
to be at cross purposes	mieć sprzeczne cele
to ramp up a business	rozkręcić biznes
a capital intensive business	działalność wymagająca dużych nakładów kapitałowych
to accumulate	nagromadzić
an outstanding mortgage	pozostający do spłaty kredyt hipoteczny
a line of credit	linia kredytowa
a tax deductible	koszt, który można odliczyć od podatku
venture capital	kapitał spekulacyjny, wysokiego ryzyka
investment portfolio	portfel inwestycji
a return on the investment	zwrot z inwestycji
to raise funds	zebrać fundusze
oversight	nadzór

business angel / angel investor	inwestor indywidualny
demand for sth	popyt na coś
pre-determined	wcześniej ustalony
expiration	zapadalność
a warrant	świadcstwo udziałowe
current market price	aktualna cena rynkowa
a reimbursement package	pakiet wynagrodzenia
an ownership stake in a business	udział we własności przedsiębiorstwa

ANSWER KEY:

Ex. 1

- 1) a startup
- 2) to very
- 3) a debt
- 4) equity
- 5) common stock
- 6) a default
- 7) a dividend
- 8) a beneficiary
- 9) a collateral
- 10) a track record
- 11) a competitive advantage
- 12) to be at cross purposes

Ex. 2

- 1) to ramp up a business into profitability
- 2) a capital intensive business
- 3) an ownership stake in a business
- 4) real estate equity loans
- 5) to accumulate sufficient cash value
- 6) the face value of a policy
- 7) an outstanding mortgage
- 8) a line of credit
- 9) a tax deductible
- 10) venture capital

Ex. 3

- 1) an investment portfolio
- 2) a return on the investment
- 3) a rule of thumb
- 4) to raise funds
- 5) oversight
- 6) an angel investor
- 7) demand
- 8) pre-determined
- 9) expiration date
- 10) a warrant
- 11) current market price
- 12) a reimbursement package

Ex. 4

- 1) for
- 2) to
- 3) on
- 4) for
- 5) in
- 6) in
- 7) against
- 8) in
- 9) on
- 10) for
- 11) to
- 12) on
- 13) to