Financing of Entrepreneurial Venture

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Very Short Question Answer

1. Who is angel investor?

An angel investor refers to a formal entrepreneur or professional who provides starting or growth capital in promising ventures, and helps also with advice and contacts. Angel investors usually operate alone or in very small groups.

2. Define the term equity financing.

Equity financing refers to the act of obtaining funds for the business in exchange of ownership. It is the fund raised by the organization by issuing shares.

3. What is debt financing?

A method of financing in which a company receives a loan and gives its promise to repay the loan is known as debt financing. It is a mechanism of borrowing money without giving up the ownership. Debt financing is another widely adopted source of generating fund for business.

4. Mention any four sources of short term loans for venture.

The four sources of short-term loans for venture are listed as follows:

- Bank overdraft
- Trade credit
- Short-term bank loan
- Factoring

5. What do you mean by financial planning?

The long term profit planning aimed at generating greater return on assets, growth in market share, and at solving foreseeable problems is known as financial planning. In other words, it is a comprehensive evaluation of an investor's current and future financial state by using currently known variables to predict future cash flows, assets values and withdrawal plans.

6. Make a short note on venture capital.

Venture capital refers to a type of private equity or a form of financing that is provided by firms to start ups with a high growth potential. Venture capital usually comes from venture capital firms that specialize in building high risk financial portfolios.

7. What do you mean by IPO? Write.

IPO stands for initial public offering. An IPO is the first time that the stock of a private company is offered to the public. IPOs are often used by smaller, younger companies seeking capital to expand.

8. What do you mean by factoring?

Factoring is a transaction in which a business sells its accounts receivable to a third party known as a factor. A factor is a finance company or bank that buys receivables from business for a fee and then collects the payments directly from the customers.

9. Write how public deposit serves as a source of short term loan for ventures.

Public deposit refers to the unsecured deposits invited by companies from the public for working capital needs. Every time a company is in need of short term loan, it can invite public deposit by making an advertisement in the newspaper. The public can deposit money in the company and get a interest in public deposit. This way a company can meet its financial need for six months to three years.

10. Define the primary types of financing.

They are defined as follows:

- Debt financing means borrowing money and not giving up ownership. It is the fund owed by the company from another party.
- Equity financing refers to the act of obtaining funds for the business in exchange of ownership. It is the fund raised by the organization by issuing shares.

Short Question Answer

1. What is financial planning in entrepreneurship? Explain the sources of short term loans for ventures.

The long term profit planning aimed at generating greater return on assets, growth in market share, and at solving foreseeable problems is known as financial planning. In other words, it is a comprehensive evaluation of an investor's current and future financial state by using currently known variables to predict future cash flows, assets values sland withdrawal plans.

The primary sources of short term loan for ventures are discussed as follows:

Bank Overdraft

An overdraft is an extension of credit from a lending institution when an account reaches zero. The overdraft occurs when money is withdrawn from a bank account, and the available balance goes below zero. It is a provision that allows the customers to borrow a set amount of money. Usually, when you have a normal bank account check will bounce once the account has less amount than the one mentioned in the check. In such situation, having a bank overdraft account helps to fulfil your short-term financing need as it covers checks that would otherwise bounce. For this, you need to pay interest on the outstanding balance of an overdraft.

Trade Credit

Trade credit also known as account payable refers to the credit that a firm gets from its suppliers of goods. Trade credit is a primary source of spontaneous and short-term unsecured financing which is common to almost all firms. Trade credit provides one of the most flexible sources of short-term financing available to the firm. In practice, when a firm buys goods from another firm, buyer normally does not have to pay for those goods immediately. In this particular time before due payment, the purchaser has a debt outstanding to the supplier known as account payable on trade credit. The amount of trade credit is determined on the basis of daily purchases and credit period.

Short-Term Bank Loan

A bank loan is a non-spontaneous interest carrying and negotiated credit. Short term bank loan refers to those set of loan which has short term maturity period. Commercial bank provides short-term unsecured credit as:

- Transaction loan
- Line of credit
- Revolving credit agreement

Maturity of all types of short loans is normally one year or less. Short term bank loan may be secured or unsecured. When a bank is unsure and concerned about a firm's credit risk, it asks the firm to provide security.

Factoring

Factoring refers to a financial method in which a business owner sells accounts receivable at a discount to a third party funding source to raise capital. To explain it further, it is a financial service that collects receivables earlier than their maturity, where the bank emerge as buyers off their client's receivables giving them the opportunity to obtain the money. The obtained money, in turn, can be used in business. Factoring is common cash management tool for many industries where long receivables are the crucial part of the business cycle.

Accruals

Accruals represent short-term liabilities for the services that have been provided to the firm, but payment has not yet been made. The widely found common accruals are wages payables and taxes payable. The business firm pay employees on the monthly, biweekly or weekly basis. As a result, accrued wages are created. Likewise, the estimated income tax, property tax, tax deducted at source, sales tax, etc. are collected and paid after a specific period. Thus accrued taxes are created. These accrued wages and taxes can often be used as the source for the short term loan.

2. What is equity financing? Distinguish between angel investor and venture capitalist.

Equity Financing

Equity financing is the process of raising capital through the sales of shares in an enterprise. In other words, it refers to the sale of ownership interest to raise funds for business purposes. Equity financing is the most widely used source of funding a business. The investor that finances through equity gets his/her return in the form of dividend and selling their share in the premium price.

Distinguish between Angel Investor and Venture Capitalist

Angel Investor	Venture Capitalist
Angel investor is one who invests in an enterprise for his/her personal satisfaction and investment purpose. They may be an individual angel investor or a small group off investor. Angle investor usually invests in early stage or start-up business. The investment amount is around 1 million to ten millions. Decisions of angel investors are quick. Angel investors invest their own money in the form of angel investment. Angel investment is often made with willing to be 'hands -off" or "hands-on" adding important skills. The primary motivational factor of angel investor is help	Venture capitalist refers to companies or business houses that invest in entrepreneurial venture. Venture capitalists invest in the later stage of business unless compelling reasons. The investment amount is usually more than ten millions. Decisions ofventure capitalist are lengthy. Venture capitalists invest other's money in the form of venture capital. Venture capitalists usually require seat on board for their investment. The primary motivational factor of venture capitalists is to make money.

3. Write why financial planning is important for modern organizations.

The importance of financial planning for modern organizations are explained through following points:

Define Financial Goals

One of the primary objectives of financial planning is that it helps to define financial goals. When financial goals are defined, determination of financial objectives as well as estimation of capital requirements becomes easy.

Identify Necessity of Funds

Financial planning identifies the necessity of fund for a particular organization. The fund may be for different purpose such as the purchase of long-term assets, to meet day-to-day expenses, etc. If the necessities are identified, prioritizing the need and generating funds becomes easier.

Fixing the Most Appropriate Capital Structure

The arrangement of funds can be made adopting various sources. Every source has its share of advantages and disadvantages. Every structure is appropriate for a certain condition. In this regard, financial planning helps to fix the most appropriate capital structure.

Base for Financial Control

Financial planning provides the mechanism of comparing revenue and expenses of a venture. It compares actual revenue with estimated revenue as well as actual cost with the estimated cost. Based on the comparison, controlling effort can be implemented. In this regard, financial planning acts as the base for financial control.

Availability of Funds

Every organization requires fund for a number of purposes. Financial planning ensures that sufficient fund is available for the organization to accomplish different purposes. It ensures that there is the timely availability of finance.

No Raising of Resources Unnecessarily

It is a well-known fact that excess fund is equally bad as the shortage of funds. Keeping financial resources unused is just unacceptable in modern business. Financial planning ensures that every time there is the surplus fund, it is invested in the best possible manner.

Helps in Investing Finance in Right Projects

It is important to invest in a project that assures return in a sustainable manner. Financial planning uses a number of tools to compare various investment proposals thereby helping to pick the best project.

Avoid Business Shocks and Surprises

Financial planning anticipates the changes one can expect in future. It anticipates the changes in financial requirements and prepares accordingly. Due to which the organization is better prepared and hence avoids business shocks and surprises.

Proper Coordination

Financial planning acts as an interlinking mechanism between every functional unit of an organization that requires fund. This interlinkage keeps all the functional unit in the same wavelength thereby achieving proper coordination and better result.

4. Write the process of preparing to raise finance for a business.

Financing is perhaps the most crucial aspects of every business operation. Careful planning and execution of raising finance can make or break any business. Raising finance in itself is a tough job and goes through following primary stages.

Determine the Capital Necessity of the Business

The first step to raising finance involves the determination of capital necessary for the business. The determination of capital should be done from capital expenditure, and cash flow statement. The information about capital expenditure and cash flow statement can be derived directly from the business plan. An exact determination of capital provides two-fold advantage:

- Showcase the certainty of capital required to the probable investors.
- Avoid excess or deficit fund.

Identify the opt. Financing or Funding

It is the second step of raising finance. This step involves identifying the most suitable method of financing. In principle, there are two methods for financing. They are equity and debt financing. Equity financing involves raising finance in exchange for partial ownership of a firm in the form of share. Debt financing involves taking the loan for a certain period. Every method of financing has its share of advantages and disadvantages. It is important to analyze which method is beneficial for the business.

Development of Strategy for Attracting Potential Investors

It is the last step of the process and focuses on attracting potential investors. For this, a proper strategy is developed based in the essence of business along with its merit. Then the best prospects are identified, and a presentation is made to them.

5. What do you mean by equity financing? What are its sources? Write.

Equity financing is the process of raising capital through the sales of shares in an enterprise. In other words, it refers to the sale of ownership interest to raise funds for business purposes. Equity financing is the most widely used source of funding a business. The investor that finances through equity gets his/her return in the form of dividend and selling their share in the premium price.

The primary sources of equity financing are explained below:

Angel Investors

An angel investor refers to a formal entrepreneur or professional who provides starting or growth capital in promising ventures and also helps with advice and contacts. Angel investors usually operate alone. Angel investors are more about passion. They get involved in financing because they enjoy helping early stage businesses, mentoring young entrepreneurs and participating in the development of an emerging business. When we look at the history, we find that angel investors have usually been high-net-worth individuals that privately invest in the new start-up with title publicity of their involvement.

Angel investment is considered as the first round of external independent investment. Angel investors invest in early stage ventures as the entrepreneurs exhaust their personal savings and sources of funding from family and friends. Although many angels are motivated by the factors beyond financial benefits, it is usually tough funding and continuing an angel investor.

Venture Capital

Venture Capital is a type of private equity, a form of financing that is provided by firms to small, early-stage emerging firms that are deemed to have growth potential. For entrepreneurial start ups without any access to capital, venture capital is perhaps the most essential source of money. Venture capital usually comes from venture capital firms that specialize in building high-risk financial portfolios. Although the risk is high, it has the potential for above-average returns. An entrepreneur must ask the following questions to themselves before accepting venture capital.

- Do the venture capitalists have experience in our industry?
- Do they take a highly active or passive management role?
- Are the personalities on both sides of the table compatible?
- Does the firm have deep enough pockets of sufficient contacts within the venture capital industry to provide follow-on rounds of financing?
- Is the firm negotiating in good faith in regard to the percentage of our firm they want to exchange for their investment?

Initial Public Offering

Initial public offering or IPO is the first time that the stock of a private company is offered to the public. A company can raise money by issuing either debt or equity. In this regard, if the company has never issued equity to the public, it is known as IPO.

Through the initial public offering, a privately held company transforms into a public company. A public company is a corporation whose ownership is dispersed among the general public in many shares of stock that are freely traded on a stock exchange. Company usually use public offering to raise the expansion of capital. A company that sells shares is never required to repay the capital to its public investors. An IPO is often preferred to other forms of equity financing due to following reasons:

- It helps to enlarge and diversify the equity base.
- It is perhaps the cheapest access to capital.
- IPO provides better exposure, prestige, and public image.
- Creates another form of currency that can be used for company growth.
- IPO provides a mechanism for the stockholders to cash out their investment and get their money back.

6. What do you mean by IPO? What are its advantages?

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Advantages of IPO

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- IPO provides better exposure, prestige, and public image.
- Creates another form of currency that can be growth.
- IPO provides a mechanism for the stockholders to cash out their be used for company investment and get their money back.

7. Explain in brief the different sources of raising debt financing.

A method of financing in which a company receives a loan and gives its promise to repay the loan is known as debt financing. It is a mechanism of borrowing money without giving up the ownership. Debt financing is another widely adopted source of generating fund for business. Debt financing usually includes both secured and unsecured loans. Secured loans are generated with an assurance of collaterals. If the debtors default the loan, collateral will be forfeited. A few lenders, however, will just lend the money based on a name and idea.

Debt financing is often preferred over than equity financing due to following primary advantages:

- Debt financing keeps the owner's ownership interest in the company intact as the lender cannot claim the equity.
- A lender who finances the debt cannot claim on future profit of the business.
- One can deduct the interest on the debt on company's tax return. It helps to lower the actual cost of the loan.
- The legal compliance associated with debt financing is less as compared to equity financing.

The primary sources of debt financing are explained as follows:

Commercial Banks

A commercial bank is an institute that aims at gaining profit through deals related to money and credit. In this regard, it is a financial institution that accepts deposits of money from surplus region and mobilizes that in deficit region. Commercial banks are considered to be the heart of the financial market for small business. In this regard, commercial banks are the main source of debt financing. Commercial banks provide both short term loan and long term loan. To provide the loan, they usually consider the cash flow strength of the start-ups as well as the collateral and balance sheet position.

Private Sources

Sources that are more personal and not confined to any institutional structure are referred as private source. Private source could be anybody ranging from family members, relatives to colleagues, friends, etc. Entrepreneurs can also look forward to a number of private sources of debt financing. Friends, relatives, partners, etc. can lend money to the business in a term that is more flexible than bank and other lenders. One of the major drawbacks associated with private source is that they like to be involved in the management of the business.

Microcredit

A minuscule loan given to impoverished people to help them become self-employed is known as microcredit. Microcredit is also known as microlending or microloan. It is a means of extending credit usually in the form of small loans with no collateral, to non-traditional borrowers such as poor in rural or underdeveloped areas. Microcredit primarily aims to provide credit to poor people so that they are engaged in entrepreneurial activities.

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8. Write the differences between equity and debt financing.

Differentiation between Equity and Debt Financing

Debt Financing	Equity Financing
Debt financing means borrowing money and not giving up ownership. It is the fund owed by the company from another party. Debt financing on the other hand is an obligation of the company. Debt financing is temporary in nature and is raised for comparatively short period. Holders that provide debt financing are lenders. With debt financing, the risk is low as there is promise to repay the investment. Moreover, there is also an interest component. The return is in form of interest and principle amount. Debt financer often demands collateral before financing. The return of debt financing for lends is fixed and regular.	Equity financing refers to the act of obtaining funds for the business in exchange of ownership. It is the fund raised by the organization by issuing shares. Equity financing is the ownership of the company. Equity capital is raised for a long term and is permanent in nature. Holders that provide equity capital are proprietors. With equity capital the risk is high as there is no promise to repay the investment nor there is an interest component. The return is in form of dividend. The return of the equity capital is irregular and variable. Equity financer never demands collateral as they believe in the idea before investing.

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