# Financing a business

## Learn how to obtain business funds

Ulianova Ksenia

Master of Economics

Economic Department, MSU

PIE: Easy as pie

# Sources of business funds

| Funds | |
|---|---|
| Internal | External |
| Come from within a company | Come from outside |
| Equity | Debt |
| Money received from investors in exchange for a portion of the ownership of business. | Money that you will pay back, usually with interest, over a set time period. |

Main source of information – balance sheet & notes to financial statements.

# Sources of business funds

| Equity | Debt |
|---|---|
| Share capital | Trade credit |
| Reserves | Loans |
| Retained earnings | Bonds |

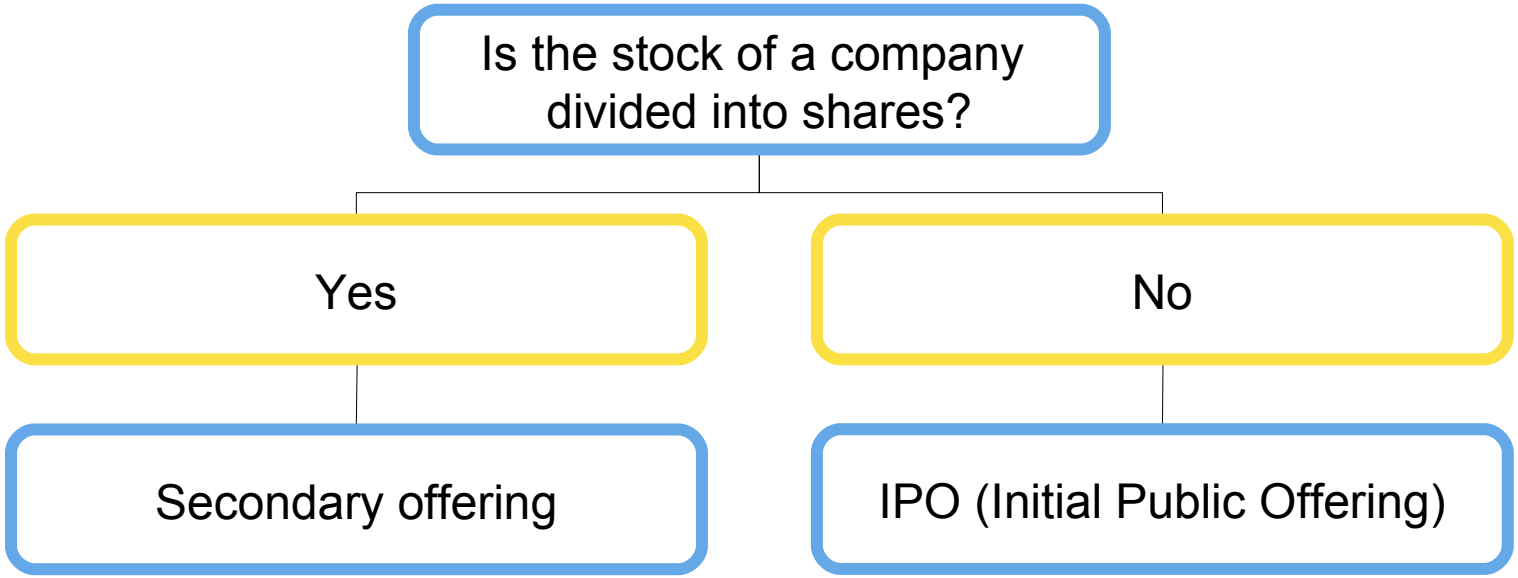
# Equity: Share capital

Portion of a company's equity that has been obtained by trading stock to a shareholder for cash.

| Features of a stock | |
|---|---|
| Nominal value | a declared face value (share capital amount) |
| Issue price | a price at which investors buy stocks when they are first issued |
| Market price | a present price at the open market |
| Dividends | payments made by a corporation to its shareholder members |

| | |
|---|---|
| **Common stocks** | Carry voting rights and right to receive dividends. |
| **Preferred stocks** | Do not carry voting rights.<br>Set a certain level of dividends and right to receive them before any other shareholders. |

# Equity: Raising share capital




<u>Issuing process:</u>

1. Making decision at stakeholders' meeting
2. Preparing documents (financial statements, offering prospectus)
3. Distributing stocks at a stock exchange

**Initial listing requirements:**

- A history of a few years of financial statements.
- A sufficient size of the amount being placed among the general public (the free float).

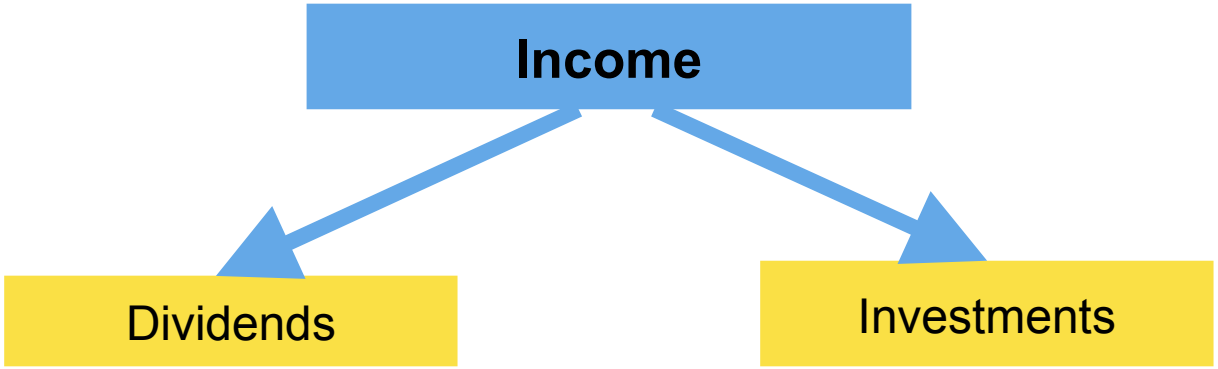
# Equity: Reserves

Reserve is the profit achieved by a company where a certain amount of it is put back into the business which can help the business in their rainy days.

| Can be created | |
|---|---|
| From shareholders' contributions | From profit |
| Share premium – amount paid by shareholders for shares in excess of their nominal value (when shares are sold at a price higher the nominal value). | Remuneration reserve – will be used to pay bonuses to employees or management. |

# Equity: Retained earnings

Retained earnings – a portion of net income which is retained by a corporation rather than distributed to its owners as dividends.

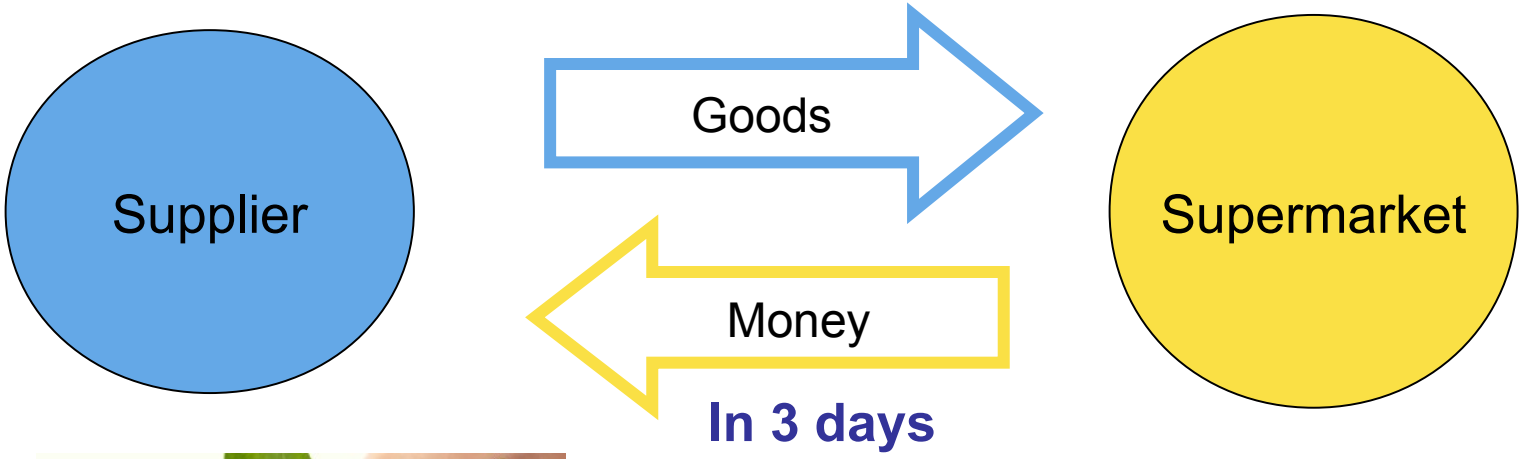



Retention – the decision of whether a firm should retain net income or have it paid out as dividends; depends on funds required for reinvestment in the corporation.

Made by shareholders at the annual meeting.

# Debt: Trade credit

Trade credit is an arrangement between businesses to buy goods or services on account, that is, without making immediate cash payment.




# Debt: Loans

Loan – a borrowing from bank or financial company.

| LOAN | |
|---|---|
| Principal debt | Interest |

Interest = P * R * T

P = Principal, amount borrowed

R = Interest rate (annual)

T = Length of a loan (years)


Loan secured by real estate – **mortgage** (*usually for long time and large loans).*

# Debt: Bonds

A bond is like a loan: issuer is a borrower (debtor), holder is a lender (creditor), and coupon is an interest.

**Main differences between bonds and stocks:**

1) Bondholders have a creditor stake in the company (i.e., they are lenders).
2) Bonds usually have a defined term, or maturity, after which the bond is redeemed.

Issuing process:

1. Making decision at shareholders' meeting
2. Preparing documents (financial statements, offering prospectus)
3. Distributing bonds at a security exchange

# Debt: Bonds

| Features of a bond | |
|---|---|
| Nominal | the amount on which the issuer pays interest |
| Issue price | the price at which investors buy the bonds when they are first issued |
| Maturity date | the date on which the issuer has to repay the nominal amount |
| Coupon | the interest rate that the issuer pays to the bond holders |

| Types of bonds |
|---|
| Fixed rate bonds |
| Floating rate bonds |
| Zero-coupon bonds |

# Time is money

| Financing | |
|---|---|
| Short-term | Long-term |
| Must be repaid within 1 year. | Come due in more than a year. |
| Used to finance everyday costs of doing business (payrolls, raw materials). | More likely to be used to purchase equipment, buildings and other high-cost items. |
| •Trade credits<br>•Short-term loans | •Long-term loans<br>•Stocks<br>•Bonds |

# Debt vs. Equity Financing: Pros & Cons

### *Debt Financing*

**Pros:**

- Typically easier to get than equity financing.
- Wide range of options available (e.g., bank loans, bonds, etc.).
- Allows you to retain control of your business.

**Cons:**

- Amount you can borrow is usually limited.
- If business fails, you still may have to pay back the money.

### *Equity Financing*

**Pros:**

- Investors can provide expertise and key contacts.
- Usually available in larger amounts than debt financing.
- If business fails, you usually don't have to pay back the money.

**Cons:**

- Investors may demand a say in running your business.
- Requires additional time to manage investor expectations.

# Thank you!