1.1. Start-up Funding for a Business

Most businesses require some sort of initial capital for things like inventory, marketing, physical facilities and incorporation expenses.

1.1.1. Funding Options

When exploring your funding options, there are several factors to consider:

- Are your needs short-term or long-term? How quickly will you be able to pay back the loan or provide return on their investment?
- Is the money for operating expenses or for capital expenditures that will become assets, such as equipment or real estate?
- Do you need all the money now or in smaller pieces over several months?
- Are you willing to assume all the risk if your company doesn't succeed, or do you want someone to share the risk?

Fundamentally, there are **two types of business financing**:

- **Debt financing** - You borrow the money and agree to pay it back in a particular time frame at a set interest rate. You owe the money whether your venture succeeds or not. Bank loans are what most people typically think of as debt financing, but we will explore many other options below.

- **Equity financing** - You sell partial ownership of your company in exchange for cash. The investors assume all (or most) of the risk--if the company fails, they lose their money. But if it succeeds, they typically make *much* greater return on their investment than interest rates. In other words, equity financing is far more expensive if your company is successful, but far less expensive if it isn't.

Here are some other options to fundraise for your new business:

- **Friends and family** are still your best source for both loans and equity deals. They are typically less stringent regarding your credit and their expected return on investment. One caveat: structure the deal with the same legal rigor you would with anyone else or it may create problems down the road when you look for additional financing. Prepare a business plan and formal documents--you'll both feel better, and it's good practice for later.

- **Credit cards** are a great tool for cash flow management, assuming you use them just for that and not for long-term financing. Keep one or two cards with no balance on it and pay it off every month to give yourself a 30 to 60 day float with no interest. And the low introductory rates on some cards make them some of the cheapest money around. Managed well, they're extremely effective; managed poorly, they're extremely expensive.

- **Bank loans** come in all shapes and sizes, from microloans of a few hundred dollars, typically offered by local community banks, to six-figure loans by major national banks. These are much easier to obtain when backed by assets (home equity or an IRA) or third-party guarantors (e.g., government-sponsored SBA loans or a consigner). If you obtain a line of credit rather than a fixed-amount loan, you don't start paying interest until you actually spend the money.

- **Leasing** is the way to go if you need big-ticket items such as equipment, vehicles, or even computers. Your supplier will help you explore this.

- **Angel investors** fill the gap between friends and family and venture capitalists, who now rarely even look at investments below $1 million. Enlist a savvy financial adviser to structure the deal.

- **Private lending** represents a viable alternative when the bank says "no". Private lenders are looking for the same information and will conduct similar due diligence as the banks, but they typically specialize in an industry and are more willing to take on higher-risk loans if they see the potential.

1.2. General Information on Finance Requirements for Business

In general usage, a financial plan can be a budget, a plan for spending and saving future income.

This plan allocates future income to various types of expenses, such as rent or utilities, and also reserves some income for short-term and long-term savings.

A financial plan can also be an investment plan, which allocates savings to various assets or projects expected to produce future income, such as a new business or product line, shares in an existing business, or real estate.

In business, a financial plan can refer to the three primary financial statements (balance sheet, income statement, and cash flow statement) created within a business plan. Financial forecast or financial plan can also refer to an annual projection of income and expenses for a company, division or department

A financial plan can also be an estimation of cash needs and a decision on how to raise the cash, such as through borrowing or issuing additional shares in a company.

While a financial plan refers to estimating future income, expenses and assets, a financing plan or finance plan usually refers to the means by which cash will be acquired to cover future expenses, for instance through earning, borrowing or using saved cash.

Financial documents include:

- Break-Even Analysis
- Balance Sheet
- Projected Profit and Loss Statement
- Projected Cash Flow Statement

The financial plan also includes the start-up budget and operations budget, indicating what you need to launch the business and how much you require keeping the business going on. This section includes:

- Salaries,
- Wages,
- Insurance costs,
- Accounting costs,
- Equipment costs,
- Legal fees,
- Taxes,
- Cost of goods sold,
- Advertising and
- Promotional expenses and all other pertinent costs in each of your two budgets.

1.2.1. How much money do you need for your start-up?

[1]Anyone setting up a company needs to start by investing money in the project. You can find out how much you need to invest by planning your capital requirement.

A **capital requirement plan is a key part of every business plan**, especially if you need to apply for government assistance or for a bank loan. Entrepreneurs who have a low capital requirement and who can therefore launch the firm without outside capital often believe that no precise planning is necessary, since the amounts involved are small and can be financed from their savings. The upshot is often that there is not enough money, and outside

[1] Reference: http://www.existenzgruender.de/englisch/self_employment/launch/capital_requirements/index.php

funding needs to be found at short notice. But by then it is too late for government loans to new start-ups, which can only be applied for before the company is founded.

A thorough planning of the capital requirements is therefore one of the basic elements of every envisaged new firm. You need to find out how much capital you require:

Capital requirements prior to start-up

Begin with the costs which accrue during your preparations for the launch. These include aspects like consultancy costs, notaries' fees, fees for registrations and permits. Speak to your start-up adviser and work out together what the start-up costs will be.

Capital requirements for the initial operational phase

How much money do you need to spend to get your company up and running? Make a distinction between fixed assets, such as licences, real estate, buildings, machinery, vehicles and office equipment, on the one hand, and current assets on the other.

The latter are the on-going operational expenses for goods, administration, distribution, staff, etc., the cost of which you will subsequently cover from your income. Since in the initial phase you will have no or little money coming in, you will need to provide the funding for this initial phase in advance.

Calculate a period of four to six months for this.

Capital requirements to cover living expenses

Do not forget, if you wish to set up a one-person business or a non-incorporated firm (e.g. a GbR), to include in your plans your personal expenses and your remuneration. This includes all the monthly spending you require for your private life.

Calculate this generously and take account of unforeseen events like illness and accidents, but also repairs to house and car. In an incorporated firm, you as the employed director would draw a salary. Therefore these costs should be included as staff costs.

Establishing the level of your personal spending thus serves as a basis for the level of your monthly "salary" and for safeguarding your lifestyle.

Financing the capital requirement

How much capital will your company earn to cover the costs, and how much additional capital will you initially have to invest in your company? In order to establish this, you need to ascertain the liquidity, i.e. the solvency of your company.

Before the launch, you must initially estimate how high your revenues will be in the first few months. After the launch, you then produce your monthly liquidity plan on the basis of actual figures.

You will need your liquidity plan to work out how much money you will be taking in in order to finance all your costs, including your personal expenses. If your costs are higher than the revenues, you will have a shortfall and will need to inject extra capital from outside, i.e.

either from your personal savings or from third parties.

Third-party financing of capital requirements

If you find that you need to finance your project not just from your own financial assets, but also using government assistance loans and/or bank loans, you should work out how high the monthly interest payments and repayments of principal will be. In the case of government assistance loans, the repayment of the principal is usually delayed.

You need to include the repayments of interest and principal in your planning of capital requirements. After all, these too are costs which (possibly with the exception of the repayments of principal) will be borne by your company from day one.

1.2.2. How would you estimate the capital requirements?

(A) ESTIMATION OF CAPITAL REQUIREMENTS:

When determining the total capital requirements of a company, the following points should be considered well:-

- **Cost of Fixed Assets:** Fixed assets like building, plant and machinery, furniture etc. form a major proportion of total capital requirements, mainly in capital incisive industries. These assets are permanent assets.
- **Cost of Current Assets:** Current assets include stock in trade, debtors and bills receivable, cash and bank balance etc. Sufficient amount of current assets is required for the smooth functioning of the business.
- **Promotional Expenses:** Promotional expenses are incurred in formation and incorporation of a company. These expenses include expenses on preliminary investigations, legal and technical advice, drafting and printing of several documents and statements like Memorandum and Articles of Association, etc., registration fee, office expenses, remuneration paid to promoters etc. Promotional expenses are not fixed and therefore, are not easy to be estimated.
- **Cost of Financing:** Cost of financing includes expenses on the procurement of capital font the ma nut/pub lie. These expenses include expenses of drafting and printing of prospectus and application forms, expenses on adverting, underwriting commission, brokerage and other expenses on the marketing securities.
- **Cost of Intangible Assets:** A new company sometimes has to acquire goodwill patent rights from an existing company. These expenses should also be taken into account while estimating the capital requirement of a new company.
- **Cost of Developing Business:** Often a large company takes some time before it starts generating profits. The operating losses likely to be incurred in the initial stage of its operation or before it reaches break-even point (no profit no loss line) are the cost of developing the business. A good financial plan should also include this cost also in estimating the capital requirement of a new company.

(B) FIXED CAPITAL AND ITS DETERMINANTS:

Fixed capital is that portion of the capital which is represented by the fixed assets such as building, plant and machinery, furniture etc. These assets are used in the business for meeting the permanent needs of the company. These assets are not for sale and are meant again and again for generating revenue. These assets are not convertible into cash within a year. Fixed assets are also known as 'block capital' because it is blocked up in fixed assets for a fairly long time.

DETERMINANTS OF FIXED CAPITAL:

The amount of fixed capital required in a business concern can be determined on the basis of the following considerations -

- **Nature of Business:** An industrial or public utility concerns require a large amount of fixed capital as compared to a trading concern.
- **Type of Manufacturing Process:** Processing (analytical and synthetically) industries require a larger/amount of fixed capital than assembly and service industries. If an industry is highly mechanized, its investment in fixed capital is higher as compared to industries having less degree of mechanization.
- **Scale of Operation:** A large scale manufacturing unit requires a larger amount of fixed capital than an industrial unit carrying on its operation on small scale. For instance, a large steel plant like Tata Iron and Steel Company requires huge investment in fixed assets in comparison with a mini steel plant.
- **Mode of Acquiring Fixed Assets:** Mode of acquiring fixed assets determines the need of fixed capital. A firm may acquire asset on cash down basis (outright purchase for cash) or on hire purchase or instalment basis. In former case, the amount of investment in fixed assets will be very high. In the latter case, the need will be very low as the asset can be acquired under this mode only at the time of making initial down payment. Acquiring land and building and other assets or on lease on hire (instead of outright purchase) and the other facility of sub-contracting work to outside firm tend to reduce the fixed capital requirements.
- **Technique of Production:** The technique of production also affects the total requirements of fixed capital. If a manufacturing concern using capital intensive technique requires larger amount of fixed capital than the concern of the same size using labour intensive technique. Thus, shifts technology lead to changes in the amount of fixed capital.