Financing a start-up business

Sources of finance

http://business.gov.in

Business Portal of India

Long-term finance may be raised by companies from the following sources:

Capital market

Capital market denotes an arrangement whereby transactions involving the procurement and supply of long-term funds takes place among individuals and various organizations. In the capital market, the companies raise funds by issuing shares and debentures of different types.

When long-term capital is initially raised by new companies or by existing companies by issuing additional shares or debentures, the transactions are said to take place in the market for new capital, referred to as ‘New Issue Market’. But, buying and selling of shares and debentures already issued by companies takes place in another type of market - the ‘Stock Market’.

Individuals and institutions which contribute to the share capital of the company become its shareholders. They are also known as members of the company. Before shares are issued, the directors of the company have to decide on the following matters:

- The amount of capital which is to be raised by the issue of shares;
- The types of shares which will be issued; and
- The time of issuing the shares.

When a company decides to issue additional shares at any time after its formation or after one year of the first allotment of shares, it is required under law that such shares must be first offered to the existing shareholders of the company. If the offer is declined by the existing shareholders, only then can the shares be issued to the public. Such an issue is called ‘rights issue’ and these shares are known as ‘rights shares’. The Government controls the issue of shares and debentures under the Capital Issues (Control) Act, 1947.

Special financial institutions

A large number of financial institutions have been established in India for providing long-term financial assistance to industrial enterprises. There are many all-India institutions like Industrial Finance Corporation of India (IFCI); Industrial Credit and Investment Corporation of India (ICICI); Industrial Development Bank of India (IDBI), etc.

At the State level, there are State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs). These national and state level institutions are known as ‘Development Banks’. Besides the development banks, there are several other institutions called ‘Investment Companies’ or ‘Investment Trusts’ which subscribe to the shares and debentures offered to the public by companies. These include the Life Insurance Corporation of India (LIC); General Insurance Corporation of India (GIC); and Unit Trust of India (UTI).

Leasing companies

Manufacturing companies can secure long-term funds from leasing companies. For this purpose a lease agreement is made, whereby plant, machinery and fixed assets may be purchased by the leasing company and allowed to be used by the manufacturing concern for a specified period on payment of an annual rental.

At the end of the period the manufacturing company may have the option of purchasing the asset at a reduced price. The lease rent includes an element of interest besides expenses and profits of the leasing company.

Foreign sources

Funds can also be collected from foreign sources which usually consists of the following:

- **Foreign collaborators**: If approved by the Government of India, the Indian companies may secure capital from abroad through the subscription of foreign collaborators to their share capital or by way of supply of technical knowledge, patents, drawings and designs of plants or supply of machinery.
- **International financial institutions**: The World Bank and the International Finance Corporation (IFC) provide long-term funds for industrial development all over the world. The World Bank grants loans only to the Governments of member countries or private enterprises with guarantee of the concerned Government. IFC was set up to assist private undertakings without the guarantee of the member countries. It also provides them risk capital.
- **Non-resident Indians**: Persons of Indian origin and nationality living abroad are also permitted to subscribe to the shares and debentures issued by the companies in India.

Retained profits or reinvestment of profits

An important source of long-term finance for ongoing profitable companies is the amount of profit which is accumulated as general reserve from year to year. To the extent profits are not distributed as dividend to the shareholders, the retained amount can be reinvested for expansion or diversification of business activities. Retained profit is an internal source of finance. Hence it does not involve any cost of floatation which has to be incurred to raise finance from external sources.

Short-term finance

Trade credit

This is the credit which the firms get from its suppliers. It does not make available the funds in cash, but it facilitates the purchase of supplies without immediate payment. No interest is payable on the trade credits. The period of trade credit depends upon the nature of the product, location of the customer, degree of competition in the market, financial resources of the suppliers and the eagerness of suppliers to sell their stocks.

Installment credit

Firms may get credit from equipment suppliers. The supplier may allow the purchase of equipment with payments extended over a period of 12 months or more. Some portion of the cost price of the asset is paid at the time of delivery and the balance is paid in a number of installments. The supplier charges interest on the installment credit which is included in the amount of installment. The ownership of the equipment remains with the supplier until all the installments have been paid by the buyer.

Accounts receivable financing

Under it, the accounts receivable of a business concern are purchased by a financing company or money is advanced on security of accounts receivable. The finance companies usually make advances up to 60 per cent of the value of the accounts receivable pledged. The debtors of the business concern make payment to it which, in turn, it forwards to the finance company.

Customer advance

Manufacturers of goods may insist that customers make a part of the payment in advance, particularly in cases of special order or big orders. The customer advance represents a part of the price of the products that have been ordered by the customer and which will be delivered at a later date.

Bank credit

Commercial banks play an important role in financing the short-term requirements of business concerns. They provide finance in the following ways:

- **Loans**: When a bank makes an advance in lump sum, the whole of which is withdrawn to cash immediately by the borrower who undertakes to repay it in one single installment, it is called a loan. The borrower is required to pay the interest on the whole amount.
- **Cash credit**: This is the most popular method of financing by commercial banks. When a borrower is allowed to borrow up to a certain limit against the security of tangible assets or guarantees, it is known as secured credit, but if the cash credit is not backed by any security, it is known as clean cash credit. In case of clean cash credit the borrower gives a promissory note which is signed by two or more sureties. The borrower has to pay interest only on the amount actually utilized.
- **Overdrafts**: Under this, the commercial bank allows its customer to overdraw his current account so that it shows the debit balance. The customer is charged interest on the account actually overdrawn and not on the limit sanctioned.
- **Discounting of bills**: Commercial banks finance the business concern by discounting their credit instruments like bills of exchange, promissory notes, etc. These documents are discounted by the bank at a price lower than their face value. ❐

SMEnetwork

The SMEnetwork is a unique network of Small and Medium Enterprises (SME) Associations and their members. It is coordinated by FISME, a national body of SMEs, along with SME associations present in the country. The SMEnetwork aims at creating a unique Internet-based infrastructure which encompasses the following:

- A marketing platform composed of SMEs with data verified by associations;
- A one-stop source of information;
- Communication tools for information exchange between associations and their members; and
- SME e-communities, both sectoral and geographic.

The SMEnetwork has 4 pillars: Information component, Web-enabling component, Networking component, and Interactive component.

The uniqueness of the SMEnetwork

- The concept of creating a website/portal/marketplace of only those companies whose credentials are certified by the local association. The concept of decentralization; letting the people manage and update the information they need/use.
- Involving the local associations, state-level associations and sectoral associations for their valuable contributions and knowledge.
- Providing information, keeping only SMEs in mind;
- Giving all the registered members a web presence;
- Having a reliable, trusted database of SMEs operating in the country;
- Forming vertical and horizontal communities amongst the SME and making them a force to reckon with;
- A fully-networked portal which aims to network all the states, districts and industrial sectors and its products across the country;
- Having interactive components like e-mail, messenger and trade leads for registered members; and
- News and flash messages for all states, districts, sectors, etc.

For more information, access: *http://www.smenetwork.net*

Start-up finance management

How do I prepare a balance sheet?

http://www.technopreneurdevelopment.net.my

Technopreneur Development Division, Multimedia Development Corporation Sdn Bhd, Malaysia

All balance sheets follow the same format. If it is in two columns, assets are on the left, liabilities are on the right, and net worth is beneath liabilities. If it is in one column, assets are listed first, followed by liabilities and net worth.

There are four basic steps to follow when preparing a balance sheet:

Complete the current asset section

Current assets comprise anything of value that is due to the business.

They mature in less than one year and comprise among others:

- Cash;
- Accounts receivable;
- Inventory;
- Notes receivable; and
- Other current assets such as prepaid expenses, for example, cash used to purchase in full goods or services, the benefit of which will be received within the next 12 months. Insurance is the most common form of prepaid expense. Miscellaneous and other current assets generally consist of small deposits or receivables.

Complete the fixed asset section and the other asset section and compute the total assets of your business

Fixed Assets are those that produce revenues and are not for resale. Being new, your company may not own a lot of fixed assets. These include furniture and fixtures, motor vehicles, buildings; land, renovation, etc. Make sure you account for depreciation. Patents, royalty arrangements and copyrights are also considered as intangible fixed assets.

When purchased, a fixed asset is recorded at cost. As it depreciates, an amount is accumulated on an annual basis and this is known as accumulated depreciation.

Gross fixed assets (Purchase price - Accumulated depreciation) = Net fixed assets (Book value)

Complete the liabilities section. Compute total liabilities.

Liabilities are claims of creditors against the assets of the business. They are debts owed by the business. There are two types of liabilities: current liabilities and long-term liabilities.

Current liabilities are accounts payable (to suppliers or other creditors); notes payable to banks (or others), accrued expenses (such as wages and salaries), taxes payable, the current-due within one year-portion of long-term debt and any other obligations to creditors due within one year from the date of the balance sheet.

Long-term liabilities are debts that you must repay within 1 year from the date of the balance sheet. This may include start-up financing from relatives, banks, finance companies or others.

Complete the net worth section

Net worth is the formula that defines the balance sheet:

Net worth = Assets - Liabilities

Net worth is what you have left over after taking away liabilities of the business.

When this is done, you should have a completed balance sheet for your business.

Here is a sample balance sheet:

Assets	RM
Current assets	
Cash on hand	300
Cash at bank	2,200
Accounts receivable	1,600
Merchandise inventory	5,500
Prepaid expenses	
Rent	1,200
Total current assets	10,800
Fixed assets	
Equipment and fixtures	1,200
(less depreciation)	
Total assets	12,000
Liabilities	
Current liabilities	
Accounts payable	1,100
Notes payable, Bank	2,200
Accrued payroll expenses	500
Total current liabilities	3,800
Long-term liabilities	
Notes payable, 2000	5,500
Total liabilities	8,800
Net worth*	3,200
Total liabilities and Net worth	12,000
*Net worth = Assets ¨C Liabilities	

The Balance sheet is designed to show how the assets, liabilities, and net worth of a business are distributed at any given time. All balance sheets contain the same categories of assets, liabilities, and net worth.

- Assets are arranged in decreasing order of how quickly they can be turned into cash (liquidity).
- Liabilities are listed in order of how soon they must be repaid, followed by retained earnings (net worth or owner's equity).

Profit and loss account

The second primary report included in a business's financial statement is the profit and loss account. This is a measurement of a company's sales, expenses and profitability over a specific period of time. It is also prepared at regular intervals (again, each month and at fiscal year end) to show the results of operations during those accounting periods.

The profit and loss statements contain uniform categories of sales and expenses that include net sales, cost of goods sold, gross margin, selling and administrative expense (operating expense), and net profit.

There are two reasons why you need to prepare a profit and loss statement.

- To determine whether you are making money. It helps you monitor operations and will give you important information regarding revenues and expenses; and
- You would need to submit this statement to the Inland Revenue Board as it records your business' operation. It would be used to assess taxes on profits earned.

Profit and loss categories

The profit and loss statement uses data from your business and three simple calculations to tell you the net profit/loss of your company.

A basic profit and loss statement would cover:

Net sales - Cost of goods sold	= Gross margin
Gross margin - Selling and administrative expense	= Net operating profit
Net operating profit + Other income - Other expense	= Net profit before taxes
Net profit before taxes - Income taxes	= Net profit (or net loss)

"Quick Guides" on urban housing

The Asia-Pacific arm of the United Nations and the UN agency dealing with housing are launching a free on-line "Quick Guides" to help policy-makers deal with the key issues of housing urban poor in the region. The Quick Guides, jointly developed by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) and UN-HABITAT, are in response to the unprecedented growth of slums and squatter settlements that over 500 million people in the Asia-Pacific region call home. The seven Quick Guides are presented in an easy-to-read format. They include an overview of trends and key issues, and recommendations of policies and tools.

Urbanization - **The role of the poor in urban development** deals with changing the perspective on urban poor settlements from a drain on resources to a potential resource for their own development. This guide looks at some of the current trends in urbanization and examines housing policies and programmes that have made things worse as well as some that show a new direction and opportunities for improvement.

Low-income Housing - Approaches to help the urban poor find adequate accommodation describes ways to provide low-income housing, and examines alternative strategies to improve slums and provide new, adequate and affordable low-income housing on a city-wide scale.

Land - A crucial element in housing the urban poor looks at the fact that the inaccessibility of affordable land is the major reason why there are so many slums in Asian cities. The guide examines conventional and more innovative land tenure strategies for governments, community organizations and civil society organizations that help make land available to the poor.

Evictions - Alternatives to the whole-scale destruction of urban poor communities shows the eviction of poor households and poor communities is increasing in Asian cities, causing displacement, misery and impoverishment for millions. This guide explores several practical alternatives to eviction which are being tested in Asian countries, and presents guidelines to help governments and policy-makers minimize eviction.

Housing Finance - Ways to help the poor pay for housing introduces some key housing finance concepts and provides an overview of how housing finance works, especially as it relates - or fails to relate - to the urban poor, and looks at new alternative housing finance strategies.

Community-Based Development - The poor as agents of development shows that the emergence of community organizations of the poor in Asia has been a very important development, allowing poor communities to move from isolation and powerlessness into collective strength. Understanding how they develop and function and what tools they use is of great value to policy-makers.

Rental Housing - A much neglected housing option for the poor shows that rental housing is an important option but governments in Asia which have done little to support improvement of existing rental housing. This guide discusses issues of demand and supply of rental housing and presents policy options to regulate, promote and expand rental housing, particularly for the urban poor.

The "Quick Guides", as well as a set of posters highlighting their key messages, can be freely downloaded from *www.housing-the-urban-poor.net*.

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