

## ENTREPRENEURSHIP CONTINUED

### SOURCES OF BUSINESS FINANCE

There are two main sources of finances for a business:

-Equity financing

-Debt financing

#### 1. Equity Financing

This is use of money raised by the entrepreneur or other investors interested in business ownership rather than lending the finances to the entrepreneur

#### Sources of equity finance include:

**Personal Savings:** - This has the advantage of speed and stability as there are no claims from other investors to be considered. But if the enterprise fails, you lose everything. There may be a limit to the investable funds you have at your disposal. This limits the size of the project you can undertake on your own.

**Family members, Friends and associates:** - It is not usual to turn to friends and relations to argue your own investment. There are also sometimes when well to do outsiders might be willing to help. These can be a former employer or other businessmen whose business enterprises might be furthered by the new undertaking. Friends, relatives and other individual sponsors as sources of business financing are more desirable in that, they do not have formal investment evaluation criteria. Instead they rely on their assessment of the character of the businessmen who asks for equity support.

**Guarantors:** - Business associates may agree to offer securities to guarantee a new enterprise's obligation vis-à-vis banks or other institutions. Guarantors however, seem to have a tendency to need their securities for other purposes at the most inappropriate times. This leads to protracted



haggling and loss of valuable management time. Still, lack of red tape and the informality of investment to documentation are strong advantages if compared with other forms of funding.

**Business Angels:** Angels are wealthy individuals willing to invest in new ventures from which professional venture capitalist see no profit pay off. They are entrepreneurs, retired executives or professionals who have an interest in supporting upcoming entrepreneurs in areas of interest. They aim at employment creation, helping minority or disadvantaged groups, and personal satisfaction.

**Venture capitalists:** These are entrepreneurs who provide finance to poorly performing business with profit potential or high-risk entrepreneurial businesses. They provide startup capital; business revival funds development funds and expansion funds to rapidly growing businesses.

**Public floatation:** This means raising capital by offering shares in the stock market to a pool of private investors

**Retained profits:** These are profits that a business venture generates and are potentially available to be reinvested in its development in the next financial year.

**Government grants and subsidies:** Those planning to startup businesses in line with government policy will have a much easier time finding government grant programs that may provide business startup money.

**Strategic commercial partnerships:** These include searching for business partners, mergers and joint venture opportunities.

## 2. Debt Financing

The use of debt to finance a new or existing venture involves a pay back of the funds plus a fee (interest) for the use of the money.

Sources of Debt Finance

### Short-Term Loans

Short-term loans are repayable in a period of more than one year



### **Bank overdrafts**

This applies to all stages of an enterprise's development. Unfortunately, amongst wholesalers and bankers, lack of personal acquaintance, hence confidence restricts their willingness to lend to new enterprises. Bankers also pay attention to the borrowers' equity and overall financial position.

### **Trade Credit**

In this case the owner of the business obtains goods on credit from suppliers to be paid at a later date. The payment may be made in a month, two months or three months' time.

With suppliers and bankers, confidence is the most important factor. It affects the amount of credit that can be made available and its terms and conditions. Consequently, the more mature and well known an enterprise, the higher the trust its business partner will place into it and the better the terms they are willing to offer.

Businessmen should learn that most suppliers cooperate if they are honestly informed and if the clients are known to honor their commitments. Apart from confidence, commercial banks also ask for securities for overdrafts and other working capital loans. The banking arrangement is a working relationship with mutual give and take and based on mutual trust. However, do not forget to review it occasionally to assure that you get the required services at a competitive price.

### **Long-Term Loans**

Commercial banks, finance companies are unlikely to provide new companies or small enterprises with long term funds. Generally, applicants find that the appraisal and approval process requires extensive documentation and tends to be rather lengthy. Long term lenders in the private sector insist on highly protective terms and conditions. To overcome the shortage of long-term funds, businessmen can turn to specialized financial institutions which provide funding at reasonable terms. These include Sacco's, insurance companies and micro finance institutions.

### **Hire purchase and leasing**



Rather than pay for the asset outright using cash, it can often make sense for businesses to look for ways of spreading the cost of acquiring an asset, to coincide with the timing of the revenue generated by the business. The most common sources of medium-term finance for investment in capital assets are Hire Purchase and Leasing.

Leasing and hire purchase are financial facilities which allow a business to use an asset over a fixed period, in return for regular payments. The business customer chooses the equipment it requires and the finance company buys it on behalf of the business.

Many kinds of business asset are suitable for financing using hire purchase or leasing, including: Plant and machinery, Business cars, Commercial vehicles, Agricultural equipment, Hotel equipment, Medical and dental equipment, Computers, including software packages and Office equipment.

### **Hire purchase**

With a hire purchase agreement, after all the payments have been made, the business customer becomes the owner of the equipment. This ownership transfer either automatically or on payment of an option to purchase fee.

For tax purposes, from the beginning of the agreement the business customer is treated as the owner of the equipment and so can claim capital allowances. Capital allowances can be a significant tax incentive for businesses to invest in new plant and machinery or to upgrade information systems.

Under a hire purchase agreement, the business customer is normally responsible for maintenance of the equipment.

### **Leasing**

This is a legal contract outlining the terms under which one party agrees to rent property from another party. A lease guarantees the lessee use of an asset and guarantees the lessor regular payments from the lessee for a specified number of months or years. Both the lessee and the



lessor must uphold the terms of the contract for the lease to remain valid. The fundamental characteristic of a lease is that ownership never passes to the business customer. Instead, the leasing company claims the capital allowances and passes some of the benefit on to the business customer, by way of reduced rental charges. The business customer can generally deduct the full cost of lease rentals from taxable income, as a trading expense. As with hire purchase, the business customer will normally be responsible for maintenance of the equipment.

### **FACTORS TO CONSIDER WHEN CHOOSING THE SOURCE OF FINANCE**

- The purpose for which funds are needed e.g. the funding for a film

The source of finance depends on the purpose of the funds which include

Meeting startup costs this is mostly from equity funding

Operating expenses e.g. salaries, bills, transport

Business expansion e.g. acquiring a bigger premise, modernizing facilities, new product development etc. debt finance is appropriate for this purpose.

- Conditions of borrowing

Different lending institutions have different conditions e.g. repayment terms, collateral and repayment period. The entrepreneurs should look for a financier with the most favorable conditions.

- The amount required

Depending on the ability financial institutions have different lending capacity. If the amount require is too large Saccos and microfinance institutions may lack the lending capacity. The entrepreneur may approach a formal financial institution, strategic partners or consider going public.

- The Cost of funds



These may include the interest rate, administration cost and insurance. One should use the most affordable source.

## 2. BUSINESS EXPANSION

For any business to prosper it requires growth and expansion. After sometime the business reaches its peak and does not find any way to proceed further, at this time an intelligent businessman tries to find out some innovative ways by which the business can proceed further and achieve success. Businessmen come up with new strategies that help the business to climb new frontiers. A business survives only if there is something new in its business policy, consumers like changes and react positively to changes therefore they always want to try and purchase something that is new. A small business grows into a big enterprise only if it grows and expands. It is therefore important for all businessmen to find out new techniques and plans to carry their business forward.

Some of the main business expansion strategies that businessmen can follow are as follows:

### 1) Intensive strategies

These include market penetration, market development and product development since they require intensive efforts to improve a firm's competitive position with existing products.

- a) **Market penetration:** Seeks to increase the market share for present products or services in present markets through greater marketing efforts. It includes:
  - Increasing the number of salespersons
  - Increasing publicity efforts
- b) **Market development:** This involves introducing present products or services into new geographic areas.
- c) **Product development:** Is a strategy that seeks increased sales by improving or modifying present products or services.



## 2) Diversification strategies

There are two diversification strategies

- Concentric
- Conglomerate diversification

- Diversification strategies are becoming less popular as organizations find it more difficult to manage diverse business activities
- Businesses are selling or closing less profitable divisions in order to focus on core business

### a) Concentric diversification

This refers to adding new, but related products or services.

**b) Conglomerate diversification:** This refers to adding new unrelated products or services. It's based on profit considerations.

## 3) Integration strategies

These include: Forward, backward and horizontal integration

### a) Forward integration

This involves gaining ownership or increased control over distributors or retailers.

Forward integration may be an effective strategy when:

- (i) An organization's distributors are expensive, unreliable or incapable of meeting the firm's distribution needs.
- (ii) The availability of quality distributors is so limited (as to offer a competitive advantage to those firms that integrate forward)
- (iii) An organization competes in an industry that is growing and is expected to grow markedly.
- (iv) An organization has both capital and human resource needed to manage the new business of distributing its own products.
- (v) The advantage of stable production are particularly high
- (vi) Present distributors or retailers have high profit margins therefore a company could profitably distribute its own products and price them more competitively by forward integration.



**b) Backward integration**

This is a strategy of seeking ownership or increased control of a firm's supplies.

This strategy is effective when:

- i) The company present SS are especially expensive, or unreliable or incapable of meeting the firm's needs for parts, compounds, assemblies or raw materials.
- ii) The number of SS is small and the number of competitors is large.
- iii) The organization competes in an industry that is growing rapidly.
- iv) The organization has both capital and human resource to manage the new business of supplying its own raw materials.
- v) When the advantage of stable prices are particularly important, the firm can stabilize the cost of its R/M.
- vi) The present supplies have high profit margins.
- vii) When the organization needs to acquire a needed resource quickly.

**c) Horizontal Integration**

- This is a strategy seeking ownership of or increased control over a firm's competitors.
- This is one of the most significant trends in strategic management today.
- Mergers, acquisitions and takeovers among competitors allow for increased economies of scale and enhanced transfer of resources and competencies.
- Horizontal integration may be an effective strategy when:
  - i) An organization can gain monopolistic characteristics in a particular area or region without being challenged by federal government.
  - ii) When an organization competes in a growing industry.
  - iii) Increased economies of scale provide major competitive advantages.
  - iv) An organization has both the capital and human talent needed to successfully manage an expanded organization.
  - v) Competitors are declining due to a lack of managerial expertise or a need for particular resources that an organization possesses.



4) Franchise: This business expansion strategy is useful for a business that has a brand products that are already recognized by consumers. Franchising existing products and services is a very good way of reaching more and more consumers globally. If the product is a global brand then there may be many companies ready to take a franchise for its products. For this the companies will require a license fee to market the products or services in their areas. The business can be franchised within the country or outside the country. This business strategy is cheaper than opening branches as it does not involve setting up a branch, you can directly start selling the products by giving a franchise to an already existing business setup. This method will expand the business faster.

5) Business Alliances:

There are companies that join their business with other business to boost their sales in a particular region or area. This strategic business alliance brings success to your business as you can benefit from merger of ideas, manpower and capital. The expertise of one business can benefit the other business and thus both can prosper at the same time. For example two small banks can come together to face tough competition from a bigger bank. The merger will bring in more customers and will create additional business growth.

6) Going Global:

With the invent of faster modes of communication going global is a very good business expansion strategy to achieve faster growth for companies that have achieved success in their respective countries. There are many countries that may require your business products or services therefore expanding your markets globally will be very profitable.

7) Renovating or restructuring business:

Sometimes the business may seem to reached its peak but this may not be true. The business may not have reached its ultimate level of success because of the narrow vision of its management. They may not have tried new techniques or policies to improve its business. In this scenario



restructuring the business will bring in more momentum to an already existing business. It may be necessary for the management to replace its existing staff and appoint new people with innovative ideas for business expansion.

The above business expansion strategies will be useful only if there is extensive marketing and publicity. The success of any business depends upon good advertising and marketing. In the absence of marketing, people will not be aware of the new business products and plans. A successful business man will make new innovations that will promote new business plans and expand the business to new horizons.

