CAPACITARTE

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Curso de inglés económico, de finanzas y tributos
Module 6

Business Finance

1. Business Capital

When people want to set up or start a company, they need money, called **capital**. Companies can borrow this money, called a **loan**, from banks. The loan must be paid back with interest.

Capital can also come from issuing **shares or equities** (certificates representing units of ownership of the company). The people who invest money in shares are called shareholders. The money they provide is known as **share capital**. Individuals and financial institutions, called investors, can also lend money to companies by buying **bonds** (loans that pay interest and are repaid at a fixed future date).

All the money coming into a company during a given period is **revenue**.
Revenue minus the cost of sales and operating expenses (such as rent and salaries) is known as **profit**, **earnings** or **net income**. The part of its profit that a company pays to its shareholders is a **dividend**.
Companies pay a proportion of their profits to the governent as tax, to finance government spending. They also retain some earnings for future use.

Money that is owed (which means to be paid) to other people or businesses is a debt. In accounting, companies' debts are usually called **liabilities**. Long-term liabilities include bonds; short-term liabilities include debts to suppliers who provide goods or services on credit. The money that a business uses for everyday expenses or has available for spending is called **working capital**.

2. A Business Plan

If you have a brilliant idea for a new product or service, or a better or cheaper way of supplying and existing product or service, you will probably require finance: money to start up a company to take this market opportunity, or to expand an existing company. If

you want to interest venture capitalists in your project, you'll have to prepare a business plan.
Business plans begin with a summary, often called an **Executive Summary**, which explains in one or two pages:

- What sort of company it is
- What the product or service is, and what is special about it
- Who the managers are
- How much money you need, and what you will use it for.

If the company already exists, the first chapter of the business plan explains how it was started and how it has grown, and gives a history of sales and profits. It describes the company today, and the plans for the future.

The second chapter describes what you already sell or want to sell. It explains what differentiates the product or service from other existing ones – what makes it different or unique. It focuses on the **benefits or advantages** for customers – how it will improve people's lives.

The chapter on the **market** describes the industry you operate in, the market segments, the other firms in the market (your competitors), changes in the industry, and projected trends – forecasts for the future – and technological opportunities. It outlines what the customer need, where they are, and how you plan to reach them. It explains how you will make sure that customers know about your product or service and why they will prefer it to the competition.
It gives details of your marketing strategy, including **sales tactics**- the way you plan to achieve sales, advertising, publicity and sales promotions- incentives to encourage customers to buy.

The chapter on the **management team** gives details about the most important staff.

The chapter on **strategy** outlines your strategies for marketing, pricing, distribution, sales, among others, and how you are going to implement them or carry them out.

The **financial analysis** gives details of historical performance, if it is an existing company, and describes existing finance and assets. It explains why the business needs

funds, and gives **sales forecasts** (the sales the business experts to achieve in a particular period of time), projected or expected financial statements (profit and loss account, cash flow statement, and balance sheet), and projections for future income. It will probably include a breakeven analysis, and an analysis of financial ratios.
Various appendices can come at the end of the business plan, including the curriculum vitae (CV) of each top manager and promotional materials for your products.

3. Business Financing

Raising Capital

As you know, new businesses, **start-ups**, are private companies that are not allowed to sell stocks or shares to the general public. They have to find other ways of raising capital.

Some very small companies are to operate on money their founders have previously saved, but larger companies need to get capital from somewhere else. As everybody knows, banks are usually **risk-averse**, unwilling to lend to new companies where there is danger of not getting their money back. However, there are firms which specialize in finding venture capital: funds for new enterprises.

Some **venture capital or risk capital** use their own funds to lend money to companies, but most of them raise capital from other financial institutions. Some wealthy people, who banks call **high net worth individuals**, also known as **angels**, or **angel investors**, invest in start-ups. Although new companies present a high level of risk, they also have the potential for rapid growth and, consequently, high profits, if they are successful.

Other ways of business financing a business

Companies can find other ways of financing their business.

Equity financing is the process of raising capital through the sale of shares in an enterprise. It essentially refers to the sale of an ownership interest to raise funds for business purposes. This kind of financing spans a wide range of activities in scale and scope, from a few thousand dollars raised by an entrepreneur from friends and family, to giant initial public offerings (IPOs) running into the billions by household names such as

Google and Facebook. While the term is generally associated with financings by public companies listed on an exchange, it includes financings by private companies as well.

Equity financing is distinct from **debt financing**, which refers to funds borrowed by a business. It occurs when a firm raises money for working capital or capital expenditures by selling bonds, bills or notes to individuals and/or institutional investors. In return for lending the money, the individuals or institutions become creditors and receive a promise the principal and interest on the debt will be repaid.

Venture capitalists generally invest in the early stages of a new company. Some companies need futher capital to expand before they join a stock exchange. This is often called **mezzanine financing**, and usually consists of convertible bonds – bonds that can later converted to shares – or preference shares that receive a fixed dividend. Investors providing money at this stage have a lower risk of loss than earlier investors, but also less chance of making a big profit.

Another ways of business financing is the so called **off-balance-sheet financing**. Under this method, large capital expenditures are kept off a company's balance sheet to keep the debt to equity ratio low, especially if the inclusion of a large expenditure would break negative debt covenants. It may be used when a business is close to its borrowing limit and wants to purchase something, as a form of lowering borrowing rates, or managing risk.

Examples of this form of financing include joint ventures, research and development (R&D) partnerships and operating leases. For example, if the company needed an expensive piece of equipment, it could lease it instead of buying it or it could create a **special purpose entity** (SPE) - one of those "alternate families" that would hold the purchase on its balance sheet.

A new trend in investment is **Crowdfunding**, the use of small amounts of capital from a large number of individuals to finance a new business venture. This form of investment makes use of the easy accessibility of vast networks of people through social media and crowdfunding websites to bring investors and entrepreneurs together.

Crowdfunding has the potential to increase entrepreneurship by expanding the pool of investors from whom funds can be raised beyond the traditional circle of owners, relatives and venture capitalists. In the United States, it is restricted by regulations on

who is allowed to fund a new business and how much they are allowed to contribute. These are supposed to protect unsophisticated or non-wealthy investors from putting too much of their savings at risk. Because so many new businesses fail, their investors face a high risk of losing their principal.

Many crowdfunding projects are **rewards-based**; investors may get to participate in the launch of a new product or receive a gift for their investment. For instance, the maker of a new soap made out of bacon fat sent a free bar to each of its investors. New video games are a popular crowdfunding investment for gamers, who are rewarded with advance copies of the game.

4. Risk & Return on Investment

Because of the high level of risk involved, investors in start-ups usually expect a higher than average **rate of return** on their capital, the amount of money the investment pays.

If they cannot get a quick return in cash, they can buy the new company's shares. If the company is successful and later becomes a public company, which means it is listed on a stock exchange, the venture capitalists will be able to sell their shares then, at a profit. This will be their **exit strategy**.

Apart from return, companies might consider other issues when investing. One of the most significant issue is the **risk**, the possibility for loss on an investment. While savings deposits in banks are insured against loss, most investments carry some possibility of losing part of the money invested.

Risk and return have a direct relationship—the higher the risk of the investment, the greater the possible return. This means, low levels of uncertainty (low risk) are associated with low potential returns. High levels of uncertainty (high risk) are associated with high potential returns. The **risk/return tradeoff** is the balance between the desire for the lowest possible risk and the highest possible return.

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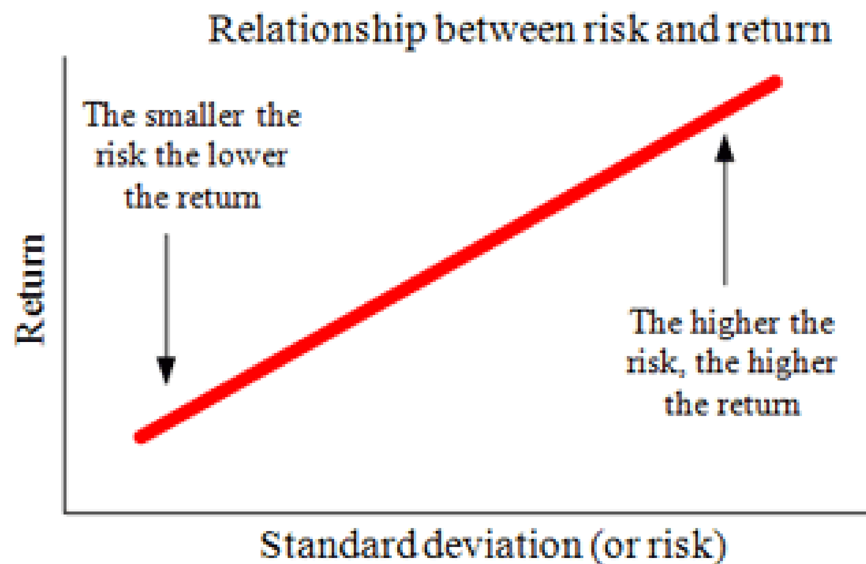

5. Asset Allocation & Diversification

Most investors try to balance risk and return through **diversification**, the practice of distributing investments among different financial assets to maximize return and limit risk.

Generally, this is done by **assets managers**, who decide how to allocate funds they are responsible for: how much to invest in shares, mutual funds, bonds, cash, foreign currency, precious metals and other types of investments. This activity of managing financial assets for institutions or individuals is known as **asset management**.

Assets managers are financial intermediaries who bring organizations or individuals and investors together. Institutions like the followings are increasingly investing in new companies:

- **Private Banks**, which specialize in managing portfolios (all the investments held by an individual investor or organization) of wealthy people.
- **Finance Companies**, which generally make small loans;
- **Mutual Funds (AmE)/Unit Trusts (BrE)**, which gather money from individual investors and purchases a range of financial assets.

- **Pension Funds**, which invest money for group of workers.
- **Life Insurance Companies**, which invest funds collected from policyholders

6. Investing Goals

Investors have different goals. Some want **regular income** from investments, they are less concerned with size of their capital.

Others want to preserve their capital, avoiding risks. If the goal is **capital preservation**, the asset manager usually allocates more money to bonds than stocks.

There are some investors who want to accumulate or **build up** capital, by taking more risks. If the goal is **growth or capital accumulation**, the portfolio will probably include more shares than bonds. Shares provide better profit potential than bonds, but they are also more **volatile** - their value can increase or decrease more in a short period of time.

7. Active and Passive Investment

As investors have different investment goals, they choose various strategies when investing.

Some of them can choose an **active strategy**: buying and selling frequently, adapting the portfolio to changing market circumstances. Others use a **passive strategy**, buying and holding securities, leaving the position unchanged for a long time.

Nowadays, there are lots of **index-linked funds** which simply try to track or follow the movements of a stock market index. They buy lots of different stocks in the index, so if the index goes up or down, the value of the fund will do so. These funds can be a good choice as most investors believe that they can't regularly **outperform** the market, that's to say, make more than average returns from the market.