Topic 5

Organise finances for new business ventures

Learner Guide

Table of Contents

BSBESB303 – Organise finances for new business ventures

Application

This unit describes the skills and knowledge required to estimate start-up costs, financial viability and projected cash flow and budget for a new business venture. It involves assessing the need to access required finances based on calculations and estimates undertaken.

The unit applies to those establishing a business providing self-employment, as well as those establishing a new venture as part of a larger organisation.

No licensing, legislative or certification requirements apply to this unit at the time of publication.

Performance Criteria

Element *Elements describe the essential outcomes.*	**Performance Criteria** *Performance criteria describe the performance needed to demonstrate achievement of the element.*
1. Prepare to organise finances for new business venture	**1.1** Establish current financial situation, showing funds available and commitments already incurred **1.2** Identify equity finance and assets from available sources **1.3** Identify business mix and forecast expected business activity over a year
2. Determine required finances for new business venture	**2.1** Estimate start-up costs for business venture according to established business activities **2.2** Estimate income and expenses for first year of operation **2.3** Project cash flow for first year of operation **2.4** Seek specialist financial advice as required according to workplace procedures **2.5** Record cash flow and budget and required finances
3. Plan to access finances for new business venture	**3.1** Investigate and source suitable types of finances **3.2** Establish methods of accessing finances and servicing any repayment schedule **3.3** Complete required documentation

Assessment Requirements

Performance Evidence

The candidate must demonstrate the ability to complete the tasks outlined in the elements, performance criteria and foundation skills of this unit, including evidence of the ability to:

- Organise finances for at least one new business venture.

In the course of the above, the candidate must:

- Investigate financial position, commitments and needs
- Determine projected cash flow and budget for business venture
- Estimate finances needed to establish and operate the business venture.

Knowledge Evidence

The candidate must be able to demonstrate knowledge to complete the tasks outlined in the elements, performance criteria and foundation skills of this unit, including knowledge of:

- Sources of specialist financial advice relating to new business ventures, including Australian Taxation Office (ATO)
- Accounting software for use in the business venture described in performance evidence
- Key financial terminology relevant to new business ventures
- Relationship between finances and sales and marketing strategies
- Workplace procedures for:
  - costing or pricing and preparing financial forecasts
  - estimating start-up costs, including cost of expenses and assets
  - seeking specialist financial advice
- Income and costs to be considered when estimating operating budget, including:
  - monthly variable and fixed costs required for business activity
  - drawings needed for business venture to be financially viable
  - monthly income generated by business venture based on price per unit item or hourly charge rate for labour
  - goods and services tax
  - operating finance required for business.

Chapter 1: Prepare to organise finances for new business venture

1.1 – Establish current financial situation, showing funds available and commitments already incurred

By the end of this chapter, the learner should be able to:

- Describe how to assess the current financial situation
- Identify business assets, liabilities and funds available
- Identify and describe commitments already incurred.

Assessing the current financial situation

One of the biggest challenges in starting a new business is to ensure that there is enough money to run the business. Financial resources play a very important role for a start-up as these ensure that the business can meet all its costs. For this, it is essential to assess the current financial situation and the funds available for an entrepreneur or the person wanting to start the business. Assessing the current financial situation usually helps an individual to know the funds available and evaluate whether these are enough for starting the business venture. The best way to assess the current financial situation is to know the current assets and liabilities.

Assets

An asset is anything of value or a resource of value that can be converted into cash. An asset might generate revenue for a company, or a company might benefit in some way from owning or using the asset. An asset can often generate cash flow in the future, such as a piece of machinery or a patent. Assets are generally listed on a company's balance sheet and captured against liabilities and equity.

The assets can usually be divided into:

- **Cash**: This refers to actual cash and anything that can be easily converted into cash
- **Investments**: Investments are the fixed assets or financial assets that can be sold for their current market value
- **Retirement assets**: An individual may have assets in the form of tax-advantaged retirements accounts like pensions that account for the assets that a person can withdraw for use in business

- **Personal assets**: These are things of present or future value owned by an individual or household. Personal assets may include personal property/house, vehicles or investments that may depreciate or appreciate.

The liabilities in the form of mortgage loans, balances due on credit cards, charge accounts and current or overdue bills need to be assessed. The net worth or the funds available can be calculated by deducting the liabilities from the assets. Essentially, assets are everything you own, and liabilities are everything you owe.

Having a positive net worth indicates that your assets are of greater value than your liabilities. On the other hand, a negative net worth indicates that your liabilities are greater than your assets; this means you would be in debt.

Business assets are things of value that support production and growth. For example, this could include machines, property, raw materials and inventory, as well as intangibles such as patents, royalties and other intellectual property.

Commitments already incurred

When starting a new business, some costs will have already been incurred and cannot be recovered by any means. These are commitment costs or the investments that have already been made. For example, when starting a new business, the investment made in the office space or purchasing a building and then maintaining the same is a commitment cost that can be recovered only by selling the assets and not otherwise. When assessing the financial situation, it is imperative to consider the committed costs as well.

Source: Investopedia, What is an asset?: https://www.investopedia.com/ask/answers/12/what-is-an-asset.asp.

1.2 – Identify equity finance and assets from available sources

By the end of this chapter, the learner should be able to:

- Describe the method of equity financing
- Identify available sources for equity finance and assets.

Identify equity finance and assets

Equity finance is capital invested in a business in return for a share of ownership or an element of control. Equity financing is a method commonly used to raise capital for starting a business. This is different to traditional lending from a bank or other financial institution as equity finance investors do not have the legal right to charge interest or be repaid by a particular date. Instead, they expect to gain capital depending on the growth and profitability of the business. During the start-up stage, equity finance plays a very important role to finance the assets required for the start-up as well as the initial operating costs that are incurred by the business.

The main sources of equity finance include:

- Angel investors: Angel investors are wealthy individuals who possess a lot of money and are ready to invest in a start-up that they feel has potential and would pay them well in the future. These investors usually contribute their business skills and knowledge to the start-up and also help the business with their connections
- Family and friends: This can be an important source of equity for new businesses
- Crowdfunding: Crowdfunding is the method wherein several people invest, lend or contribute small amounts of money to the start-up for its necessary funds. In return, these people receive financial gains or rewards from the business
- Venture capital firms: Venture capital firms are a group of companies that invest in the start-up because they think that the business will grow at a rapid pace and would appear on the stock exchange in the future. These firms invest a large amount of money in the start-up and also receive a larger stake compared to other types of investors in the start-up
- Initial public offerings: Initial public offering or IPO enables a firm to raise funds by offering its shares to the public for trading in the stock market.

An entrepreneur wanting to start a new business can use a combination of the methods listed above to get sufficient funds to start up and run it for some time before it becomes an established business.

Sources: NI Business Info, What is equity finance and is it right for your business: https://www.nibusinessinfo.co.uk/content/what-equity-finance-and-it-right-your-business. Equity NI Business Info, Six sources of equity finance: https://www.nibusinessinfo.co.uk/content/six-sources-equity-finance.

1.3 – Identify business mix and forecast expected business activity over a year

By the end of this chapter, the learner should be able to:

- Identify elements of a business mix for a start-up
- List the steps involved in forecasting business activities.

Identify elements of a business mix

Business mix refers to the range of products, services or customers that a business has. When starting a business, it is essential to know what the business will offer to its customers and how. The business mix helps a start-up to validate its offerings to the customers and prove them viable.

Generally, the elements of a business mix include:

- **Product**: Product refers to the products or the services that the new business would offer to customers. The product is usually characterised by its function, appearance, quality, packaging and several other features. When the product in a business mix has to be decided upon, the start-up needs to know the demands and needs of the customers
- **Price**: For a start-up, the pricing strategy is highly important. The price of a product includes the price at which it will be sold and also the credit terms or discounts associated with the product. Additionally, the price of the product must be such that the customers are not adversely impacted
- **Promotion**: Again, for a start-up, promotion as an element of the business mix is very important as it helps the business to be known to people. Promotion includes advertising, sponsorship as well as public relations activities that make the business more known to the customer. Start-ups usually have to incur a lot of costs when promoting the product
- **Place**: This refers to the place where the product is made, sold or distributed. It is important to ensure that the product is available to the right people at the right price and in the right place
- **People**: People refers to the staff or individuals who are involved in the business in ensuring that the customers get the products as per their needs and demands. In a business mix, people can also include the customers who get the product.

Forecasting business activities

Once the business mix has been decided, the start-up needs to define activities that would be undertaken in the years to come. Business forecasting refers to the process of predicting future developments in the business based on past trends and also the present data. A new business needs to know what operations it would carry out in the future to achieve its goals and objectives.

The process of forecasting business activities entails:

- Identifying the problem or the question that forms the basis of forecasting
- Collecting the required data and identifying the variables that need to be forecasted
- Making estimates about future business operations based on the data collected
- Choosing a business mix and model that best fits the problem and required data
- Conducting data analysis based on the business mix or model chosen to make predictions
- Identifying deviations between actual performance and forecast, and taking the required corrective action.

Source: Project Manager, Business forecasting: https://www.projectmanager.com/blog/business-forecasting.

Chapter 2: Determine required finances for new business venture

2.1 – Estimate start-up costs for business venture according to established business activities

By the end of the chapter, the learner should be able to:

- Identify established business activities
- Estimate the start-up costs for the business venture based on the activities conducted by the business.

Estimating start-up costs

When starting a new business, it is essential to estimate the start-up costs based on the activities that it will be conducting. Estimating start-up costs can be difficult and can cause major problems if done incorrectly. Creating a business start-up cost worksheet and considering how much things might cost will help you avoid any surprise expenses and help you work out if the business is viable. While there will be different costs involved depending on the industry, there are six general types of expenses that all small business start-ups tend to face.

These start-up costs help to:

- Estimate the profits of the venture
- Conduct a break-even analysis
- Attract investors for the start-up
- Secure loans for funds.

The start-up costs for the new business venture come from:

- **Market research**: There are different ways of conducting market research for a new business venture, and usually, extensive research is required for starting a new business. It is essential to know the cost of market research and what type is most affordable for the business. There are numerous ways to collect market research, including online surveys, phone calls and third-party reports
- **Supply and equipment**: Another element of start-up costs is the supplies and equipment or inventory that is required by the start-up to run the business efficiently. This includes office equipment and supplies such as pens, paper, stationery, business cards, etc.
- **Legal fees, licences and insurance**: This will vary from business to business, but is likely to be a key part of your start-up budget. You will most likely need to pay legal fees to attain the proper registrations, trademarks, and legal structures etc. Different industries will require different types of permits and licenses, and some will be more

costly than others. Additionally, you will need to purchase business insurance plans to cover all future assets such as office space, equipment, inventory, etc.

- **Payroll and training**: A new business cannot run without staff and so payroll and training form a part of the start-up costs. This should include training for yourself as well as other members of staff

- **Borrowing costs:** The new business venture would probably be funded with borrowed money, and so borrowing costs are essential constituents of start-up costs. You may need to turn to a third party or a lender to fund your first year or two and get the business up and running

- **Advertising:** It has already been mentioned that a start-up needs to promote its products so that more and more people know about them. Therefore, advertising and marketing costs are essential elements of start-up costs. This could include creating a website for the business, which may need to be outsourced to a third-party company if you are not an expert at web design.

In addition, a start-up business also needs to take into consideration costs incurred on:

- Office space and maintenance
- Insurance
- Licenses and permits
- Communications.

All these costs are added up to estimate the start-up costs. The entrepreneur needs to make arrangements for the start-up costs by approaching the relevant sources for funds.

Source: Factor Finders, How to estimate and budget for your start-up costs: https://www.factorfinders.com/startups/how-to-estimate-your-startup-business-costs

2.2 – Estimate income and expenses for first year of operation

By the end of this chapter, the learner should be able to:

- Identify different types of income, costs, and expenses for the business
- Estimate income and expenses for the first year of operation.

Estimating expenses for first year of operation

Expenses are the costs that are incurred by a business to earn revenues. Expenditure is deducted from revenue to arrive at a net income. There are different types of expenses that a business can incur during its year of operation. The most common way to categorise them is into operating vs non-operating costs and fixed vs variable costs.

The following types of expenses can be estimated in the first year:

- Operating costs: These are operational costs that are incurred by a business on a day-to-day basis. The operating costs for business include:
  - cost of goods sold (COGS)
  - marketing, advertising and promotion
  - salaries, benefits and wages
  - administrative expenses
  - rent and insurance
  - depreciation
- Non-operating costs: These costs are not related to the core operations or activities of the business. These are usually incurred from interests, taxes and impairment charges
- Fixed costs: These are the costs that remain fixed and do not change in proportion to the change in the number of products produced. The fixed costs are paid, regardless of the sales of the product. Rent is a main fixed cost, and salaries, benefits and wages, although they can sometimes be variable
- Variable costs: The variable costs change in proportion to the volume of sales. Cost of labour and raw materials generally form a part of variable costs. This can also include transaction fees, commissions and marketing and advertising costs.

Estimating income for first year of operation

For the first year of business, the start-up must estimate the income that it seeks to earn. The estimation of the income for the first year helps the entrepreneur to predict the revenues that are expected to be earned from the business.

The steps to estimate income for the first year include:

- Estimating the maximum number of sales expected
- Estimating the demand for the product to adjust the expected sales
- Specifying the price of the products to estimate the total sales revenue that can be generated

- Estimating the cost of producing or purchasing the products
- Subtracting the estimated expenses from estimated revenues to get the estimated income for the first year.

Source: CFI, Expenses: https://corporatefinanceinstitute.com/resources/knowledge/accounting/expenses/.

2.3 – Project cash flow for first year of operation

By the end of this chapter, the learner should be able to:

- Identify the elements of cash flow
- Project cash flow for the first year of operation of a business
- Create a cash flow forecast.

Elements of cash flow

The net amount of cash transferred into and out of the business is referred to as cash flow. It is the increase or decrease in the amount of money a business has. An evaluation and projection of cash flow for the first year of operations of a start-up are essential to ensure that the business is on the right track. Seeing the cash flow helps the business to know how much money it has made with the help of its primary business activities.

The elements of cash flow include:

- Cash inflows: The cash inflows are money that comes into the business. Usually, the cash inflows refer to the cash that comes from selling the products and services that the business deals in. Other sources of cash inflows include interests received from banks or dividends received from investments made
- Cash outflows: Cash outflow refers to the cash that goes out of the business. The cash outflows are based on day-to-day business activities and include money paid in the form of salaries, wages, interests, taxes and the money paid for the supplies and utilities required to conduct everyday activities.

Projecting cash flow

For new and small businesses, cash flow is one of the important aspects that determine the financial health of the business. Determining cash flow is essential to make sure you are on the right track. This helps in identifying the amount of cash your primary business activities make and how well your business generates cash without external financial assistance.

Cash flow is calculated by deducting cash outflows from cash inflows. The cash flow can be positive or negative. A positive cash flow means that the business collected more cash than it paid in the first year of operation, while a negative cash flow means it is paying out more money than is coming in. It is good for a start-up to project a positive cash flow as this means that the business can sustain its operations without depleting its cash reserves or funds.

Cash flow projecting or forecasting involves estimating your future sales and expenses. It is a vital tool for businesses as it will tell you if you will have enough cash to run the business or expand it. It will also indicate when more cash is going out of the business than coming in. Cash flow is all about timing, so it is important to be as accurate as possible on the timing of your inflow and outflow estimates.

How to project cash flow:

- Forecast your income or sales:
  - decide on a period that you want to forecast, i.e., monthly
  - estimate all the cash outflows to get an idea of how much money the business needs to bring in to cover it
- Estimate cash inflows – you will need to estimate cash inflows or sources of cash other than sales. These will vary but might include:
  - a loan that is paid back to you
  - selling off an asset
  - GST rebates and tax refunds
  - government or other grants
  - owners investing more money (adding extra equity) in the business
  - other sources such as royalties, franchise fees, or licence fees

- Estimated cash outflows and expenses – work out what it costs to make the goods/services available in your business. Expenses can be money spent on administration or operating costs. This will depend on the type of business. Other cash outflows may include:
  - buying new assets
  - 'one-off' bank fees such as loan establishment fees
  - loan repayments
  - payments to the owner(s)
  - investing surplus funds
- Compile the estimates into the cash flow forecast – start with an opening bank balance, which is your actual cash on hand. Next, add in all the cash inflows and deduct the cash outflows for each period. The number at the end of each period is referred to as the closing cash balance. This will be the opening cash balance for the next period
- Review your estimated cash flows against the actual – go back and check what you estimated against the actual cash flows for the period. This will highlight any differences so you can see why your cash flow didn't meet your expectations.

2.4 – Seek specialist financial advice as required according to workplace procedures

By the end of this chapter, the learner should be able to:

- List different reasons for seeking specialist financial advice
- Identify different types of financial advice.

Seek specialist financial advice

There are times when entrepreneurs starting a new business will need specialist financial advice. This usually happens when the entrepreneur does not know much about finances or needs help to manage the funding, operating costs, and cash flows of the business.

Mentioned below are reasons for seeking specialist financial advice:

- To help in planning the spending and saving to avoid the entrepreneur struggling to manage the finances in the long-run
- To meet the investment goals by ensuring realistic investments
- To take risks in a calculated manner to target maximum growth
- To ensure that the business and its operations are on track.

Types of financial advice

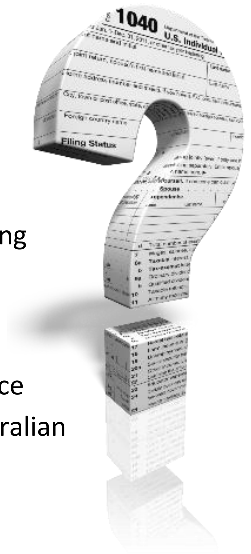
To seek special financial assistance, start-up owners can approach financial advisors; the people who have the requisite expertise in managing finances. The advisors can help you plan and manage big financial decisions for the business. You will first need to determine whether you want help with your overall financial circumstances or one specific issue. The rules around providing financial advice in Australia are very strict. You will need to follow workplace procedures when seeking advice.

The main types of financial advice include:

- General financial advice – this is providing general factual information about financial products. When providing general advice, they cannot include a recommendation or suggest a particular product that would be best for you
- Personal financial advice – this is providing personalised advice recommending a financial service or product after taking into consideration your objectives, financial situation and needs. The personal services can include:
    - simple, single-issue advice – they will help one financial issue
    - comprehensive financial advice – they will help to develop a financial plan to reach your financial goals. This would cover things like savings, investments, insurance and super and retirement planning

  - ongoing advice – they will offer regular monitoring and reviews of your financial plan and affairs

- Tax (financial) advice – this is when financial advisers recommended a financial service or product. However, they cannot provide advice about its tax implications unless they are registered with the Tax Practitioners Board



- The Australian Taxation Office (ATO) is the principal revenue collection agency of the Australian Government. Their role is to effectively manage and shape the tax and superannuation systems that support and fund services for Australians. They offer a range of products to help you understand how the law applies to you, including public and private advice and guidance

- Self-managed super funds (SMSF) advice – this is a private super fund that you manage yourself. It is a specialised area requiring advice from an experienced financial adviser or an accountant with an Australian Financial Services Licence.

Financial professionals

There are different financial professionals and services available depending on your needs. They can help you to maintain your books, create and stick to a budget, monitor cash flow, and decide on things such as buying equipment, expanding your business, and leasing or buying a commercial space.

You may consider using these professionals:

- Accountants – they can help with your business financial needs such as preparing financial statements, managing your tax and providing financial and business advice

- Bookkeeper – they can help you to keep track of your daily financial transactions, look after your banking, chase overdue payments., pay wages, and prepare some financial statements

- Business activity statement (BAS) agent – they can help you prepare and lodge your BAS to ensure you get it right the first time. They are registered professionals who are specialists in their field. Registered BAS agents can be found on the Tax Practitioners Board (TPB) register here: https://www.tpb.gov.au/registrations_search

- Financial counsellors – they can help you manage your affairs in the short term and plan for the future. Financial counsellors often provide a free, confidential and independent service. They are normally used if you are in financial difficulty.

Sources: Citizens Advice, Getting financial advice: https://www.citizensadvice.org.uk/debt-and-money/getting-financial-advice/. Money Smart, Choosing a financial adviser: https://moneysmart.gov.au/financial-advice/choosing-a-financial-adviser. Super Guide, 5-step guide to the different types of financial advice on offer: https://www.superguide.com.au/retirement-planning/seeking-financial-advice-guide-expert-help. ATO, Who we are: https://www.ato.gov.au/About-ATO/Who-we-are/. Australian Government Business, Resources to help with business finances: https://business.gov.au/finance/seeking-finance/resources-to-help-with-your-business-finances

2.5 – Record cash flow and budget and required finances

By the end of this chapter, the learner should be able to:

- List three different types of financial statements
- Identify methods to record cash flow, budget and required finances.

Types of financial statements

To record the cash flows, budget, and finance requirements, a business needs different types of financial statements, which will be required at the end of each accounting period.

The main financial statements include:

- Income statement: The income statement helps to identify the net income that the business has been able to earn over a period of several years. This statement shows the expenses and revenues of a business and helps to evaluate and assess the profitability of a business
- Balance sheet: This statement helps to show the assets, liabilities and equity of shareholders at a specific point of time in the business. This statement shows the actual picture of the financial position of the business
- Cash flow statement: The cash flow statement shows the increase and decrease in cash over different periods in the business. The statement lists cash inflows and outflows to calculate the increase or decrease in the cash available. It also allows insights into the future cash needs of the business. This can help you plan and make sure you always have money to cover payments. The statement of cash flows is comprised of three sections, including:
  - cash from operating activities
  - cash from investing activities
  - cash from financing activities.

The relationship between the balance sheet and statement of cash flows is that the cash account on the balance sheet should reflect the total cash available to the business as calculated on the statement of cash flows.

Recording cash flow

A cash flow statement can be prepared by following these simple steps:

1. Gather all the basic documents, such as balance sheet, statement of comprehensive income, statement of changes in equity, etc.
2. Calculate the changes in the balance sheet

3. Enter each change from the balance sheet to the cash flow statement

4. Adjust non-cash items from the statement of total comprehensive income and other documents

5. Add up the amounts and perform a final check.

Creating a budget

A budget is an important financial statement as it tells you how to direct your money where it is needed the most. Budgets are essential for tracking the financial health of your business. It is your planned income and spending and helps you to allocate funds for particular items and activities.

Here are some guidelines to keep in mind when recording your budget:

- Track your spending using tools or software
- Categorise your spending
- Divide your expenses into fixed and variable expenses
- Set specific budget goals
- Make adjustments to spending, if required.

How to create a budget:

- Choose a suitable time frame for your budget depending on the needs of the business, i.e., monthly, quarterly or yearly
- Enter all your fixed expenses such as salary, rent, insurance, etc.
- Enter all your variable expenses such as utilities, costs of materials, staff wages, etc.
- Enter your expected business income for the budget period
- Prepare your budget and make sure it is accurate and up to date. You may require the help of an accountant or bookkeeper to help you prepare one
- Monitor your budget using a basic bookkeeping system set up to keep track of your finances. Keep an eye on how you are tracking against your budget
- Use your budget analysis to help you make business decisions.

Sources: The Balance, How to prepare a statement of cash flows: https://www.thebalancesmb.com/how-to-prepare-a-statement-of-cash-flows-393584. CPD Box, How to prepare a statement of cash flows in 7 steps: https://www.cpdbox.com/how-to-prepare-statement-of-cash-flows-in-7-steps/. Australian Government Business, How to create a budget: https://business.gov.au/finance/accounting/how-to-create-a-budget.

Chapter 3: Plan to access finances for new business venture

3.1 – Investigate and source suitable types of finances

By the end of this chapter, the learner should be able to:

- Identify and describe different sources of finance
- Identify a suitable finance method for their business.

Sourcing suitable types of finance

For a business, finance refers to money management and ensuring that the required funds are present to carry out the day-to-day operations of the business. Finance encompasses banking, leverage or debit, credit, capital markets, money, investments, and the creation and oversight of financial systems. An entrepreneur must understand the different types of finance before making arrangements to obtain the required funds.

The different types of finance are:

- Debt finance: This is finance provided by an external lender, such as a bank, building society or credit union. Debt finance can be acquired from moneylenders at a specific rate of interest that must be paid along with the debt finance by the borrower. It can be short or long-term. Debt finance can also be acquired through retailers, suppliers, finance companies, and family or friends
- Equity finance: This is money sourced from within your business. Equity finance can be through self-funding, family or friends, private investors, venture capitalists, the stock market, government grants or crowdfunding. This type of funding is usually made in exchange for partial ownership of the business
- Personal finance: This includes the purchasing of financial products such as credit cards, insurance, mortgages, and various types of investments. Personal finance covers managing your money as well as saving and investing.

You will need to weigh the advantages and disadvantages of the different types of finance and decide which would be most suitable for your business needs. You should also make sure the chosen source of finance is affordable and manageable.

Debt finance

The advantages of debt finance:

- You retain full control of your business
- The interest on the loan is tax-deductible
- The loan can be short or long term.

The disadvantages of debt finance:

- The loan must be paid back within a fixed period
- Loan repayments will begin shortly after the loan is approved
- The loan is often secured against collateral which may include assets of the business or the owner's property
- It can be difficult to grow the business because of the cash drain of repaying the loan.

Equity finance

The advantages of equity finance:

- Less risky than a loan as the investment does not need to be paid back immediately
- You'll have more cash on hand as profits do not have to be used to repay the loan
- The investor(s) can provide additional credibility and skillsets to your business.

The disadvantages of equity finance:

- The investor(s) will want some ownership or controlling interest in your business in exchange for funding, and they will have a say in business decisions
- It takes time and effort to find the right investor for your business.

Sources: Investopedia, What is finance?: https://www.investopedia.com/ask/answers/what-is-finance/. Small Business, Business finance and loans: https://www.smallbusiness.wa.gov.au/business-advice/financial-management/business-finance-and-loans. Australian Government Business, Sources of finance: debt vs equity: https://business.gov.au/finance/seeking-finance/sources-of-finance-debt-vs-equity.

3.2 – Establish methods of accessing finances and servicing any repayment schedule

By the end of this chapter, the learner should be able to:

- Identify the methods of accessing finances for a business
- Identify how to create a debt repayment schedule.

Accessing finances for a business

Entrepreneurs will need access to suitable finance options to start up their businesses. They could make use of any of the below methods of financing a business.

These include:

- Financial institutions: Financial institutions like banks and credit unions can be approached when an entrepreneur wants to arrange finances for a business. Business owners can ask for loans from these institutions at a specific interest rate
- A fully drawn advance: This is a popular type of loan used in Australia that is commonly used as long-term business loans. They are known for being highly customisable and can be structured either as secured or unsecured loans. It is a term loan in which the borrower receives the principal upon initiation of the loan and agrees to repay the principal with interest according to a predetermined authorisation schedule. The details of the loan (i.e., fixed or variable interest) can differ depending on the lender's needs. Fully drawn advances are designed for financing the purchase of assets with long useful lives, such as real estate or long-lived equipment

- Venture capitalists: When the finance needs of a business are very high, the business owner can seek investments from venture capitalists. They can be used for start-up ventures or small companies that wish to expand but do not have access to equities markets. Venture capitalists might not always be a viable option as they are looking for a very high return on their investment and may expect some self-funding or existing equity in the business before they decide to invest
- Private investors (such as business angels): Business angels are wealthy, private investors who provide capital for young companies at the start-up phase or during times of expansion. This is different to venture capitalists, whose money is often put together by investment firms, as business angels usually invest their own money. They can also be valuable for offering their expertise and contacts/connections

- Crowdfunding: This is a way to finance your business through loans, donations or exchanging money for rewards or shares. This is generally done through a crowdfunding website, where a business idea is posted as a campaign on the website. People are then invited to support the campaign by contributing money to help you achieve your goals. You will need to set a goal for the amount of money you need, and when you want to achieve this by

- Loans from family or friends: This is often the most common source of debt financing for start-ups. Friendly loans are finance options that business owners can choose when they think that family and friends would like to invest in the business. These loans are a feasible option as the interest rates are usually low, or they may be offered interest-free. They are often easier to obtain with less security, and they may agree to a longer repayment period or lower return on investment than formal lenders.

Understanding a debt repayment schedule

A debt schedule is important for a start-up business that has been funded using debt capital. The debt schedule specifies the outstanding debts a business owns and the repayment schedule for these. The debt schedule is usually constructed on Excel and helps a business to monitor its finances and ascertain how the debts would be repaid. It is typically used by businesses to construct a cash flow analysis, and it is one of the supporting schedules that ties together the three financial statements.

The types of debt listed in the debt schedule include:

- Loans
- Leases
- Debentures
- Bonds.

The components of a financial debt schedule are:

- The opening balance (beginning of the period)
- The repayments already made by the business (decreases)
- The interest expenses to be paid on the loans
- The closing balance (end of the period).

The above items allow the debt to be tracked until maturity. The closing balance from the schedule flows back to the balance sheet, and the interest expenses flow to the income statement.

The closing balance helps the business to know how much they will need to pay once a debt matures. It also allows the company to monitor the maturity of the debt and make decisions based on it, such as the possibility of refinancing the debt through a different source when the interest rate declines. The debt schedule can also be used to negotiate new credit for the business. Lenders will use the report and consider the risk/reward before granting new credit.

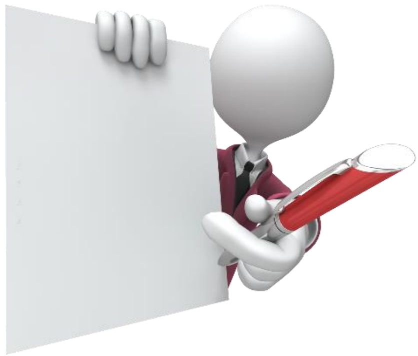
Source: CFI, What is a debt schedule?: https://corporatefinanceinstitute.com/resources/knowledge/modeling/debt-schedule/. Investopedia, Fully drawn advance: https://www.investopedia.com/terms/f/fully-drawn-advance.asp. Angel Investment Network, Business angels: https://www.angelinvestmentnetwork.co.uk/business-angels. Australian Government Business, How to crowdfund your business: https://business.gov.au/finance/seeking-finance/how-to-crowdfund-your-business.

3.3 – Complete required documentation

By the end of this chapter, the learner should be able to:

- Identify documents that may be required when seeking financing.

Completing required documentation for financing



When an entrepreneur is seeking funds for a new business, such as a loan, for example, there are certain documents and information that will be required by business lenders to acquire the necessary funding. If these documents are not provided, or incorrect information is supplied to the lender, this could lead to your business getting denied the necessary funding.

Some documents you may need to complete include:

- Credit report: Credit reports with a good score, when shown to the financial institutions or lenders, will make the business owner an ideal candidate for the loan. The credit report exhibits a history that shows the loans can be repaid by the business owner
- Bank statements: Usually, lenders want to see the bank statements of the business owners to ensure that the business is earning sufficient revenues while managing the expenses in a healthy manner
- Tax returns: Income tax returns can help illustrate how your business has performed in the past. For a new business, an accountant could help you create a projection of what your tax returns might look like in the upcoming year. It is important to balance maximising deductions while maintaining the image of consistent revenue
- Income statement: The income statement clearly shows the revenues and expenses of the business. The lenders using this statement can understand how the business has been performing and whether revenues exceed the expenses or not
- Balance sheet: The balance sheet shows the current financial position of the business. The assets and liabilities are important figures for lenders to know what the business currently owns and what it owes. If your liabilities exceed your current assets, this could cause problems with securing a small business loan with a low interest rate
- Budget and cash flow projections: These projections will help lenders identify how the business plans to utilise the financing and what your plans are for the future. For example, business owners may use the additional financing to purchase real estate, expand the business, invest in new equipment, etc.

The required documents and paperwork may vary depending on the financing option you are pursuing or the lender and their specific requirements. Nevertheless, having the documents listed above will help you in the process of securing funding.

Source: For a Financial, 6 business loan documents needed for a loan application: https://www.forafinancial.com/blog/working-capital/documents-applying-business-loan/.

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All references accessed on and correct as of 05.08.2021, unless otherwise stated.