Module 2: Funding

Overview:

As your business becomes established and grows, you may need additional funding. For example, you may need it for new equipment, to handle increased sales or market development. Being an entrepreneur requires you to make decisions about where to fund your expenses. There are several ways to finance a business. The most popular and available sources of business funding are:

- Own Financial Resources
- Funds Borrowed from Family & Friends
- Crowdfunding
- Subsidies and Grants to Support Business Ventures
- Bank Loans or Leasing

Learning Outcomes:

By the end of this module learners will:

- know the basic sources of finance that your business can use
- know the advantages and limitations of financing sources
- be able to decide what additional finance is most appropriate for your business project

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Own Financial Resources:

The use of own funds is the most popular method of financing one's own business. It is typical for new businesses that may have difficulty obtaining external funding, such as a bank loan. The table below outlines the advantages and disadvantages of using your own financial resources:

Advantages	Disadvantages
• Flexibility and freedom of disposal of your own funds. • No additional costs of engaging money and savings. • During crisis time, when external financing resources are not easily accessible, this may be the only method of financing the business project.	• There may be alternative and more favorable ways of investing your own money. • A risk of lack of financial resources for the current costs of running a business may result in the need to search for external, costly sources of financing.

Funds Borrowed From Family and Friends:

Some experts say that fundraising should start from sources called 3F's: "Friends, Family and ... Fools". Unfortunately, in many instances, especially when you are funding a new (i.e. unproven) venture, loans from friends and family are the only financial resource for the beginners in business and the only method to help fund start-ups. The table below outlines the advantages and disadvantages of using funds borrowed from family and friends.

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Advantages	Disadvantages
• Minimal formalities in obtaining funds. • Ease of changing loan terms. • No set expectations of repayment date. • Usually zero or minimal interest rate. • No additional costs of engaging money.	• Risk of losing money if personal relations between the borrower and the lender deteriorate. • Risk of deterioration/loss of personal relationship with the lender in case of loss of money. • Loans from people outside the family members require tax formalities.

Remember! When attracting capital from family members and friends you should be passionate about your business idea. Convince people on how your project could be a lucrative one. Be realistic about your capital needs by asking for funds which are just enough to fund your start up. Explain to the investor how their money is being spent and how/when they will see a return on their investment.

Sometimes, the decision to invest money in a venture turns out to be not only a very lucky decision, but a life changing one. For example, David Choe, an American graffiti artist and street painter, who was asked in 2005 to paint the interior of Facebook's first headquarters in Silicon Valley. For the work he performed he was offered shares in the company instead of payment. He agreed to take the offer- it is said that Mark Zuckerberg didn't have money to pay him for painting. David, sceptical at first about the idea and the website itself, which he considered average, agreed to take the offer. Right before Facebook's stock exchange debut, the shares he received then were worth around $200 million.

Crowdfunding:

Crowdfunding can be defined as raising money for business purposes. Various types of projects can be funded on crowdfunding platforms. In the business sphere, creative and innovative businesses which can interest potential backers- with a high probability of generating high

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profits in the future, but also with a socially/culturally important goal- generally have a chance of private funding.

On crowdfunding platforms, young companies can raise money from private investors for their activities. However, this is not charity. People who donate money to a venture are counting on profits from it. With crowdfunding, it is enough to have a well prepared promotional campaign of your proposal, alongside a really innovative project to be able to obtain the desired amount of crowdfunding.

The table below outlines the advantages and disadvantages of using crowdfunding:

Advantages	Disadvantages
• The possibility of obtaining significant capital without being creditworthy. • Popularisation of the new business idea even before its launch. • The possibility of obtaining expert and valuable feedback from investors.	• The need to disclose the business idea - the need to share it with the online community, which means that the competition too knows the future plans of the company. • The risk of not getting investors on the crowdfunding platform and losing money spent on a promotional campaign.

Remember! Different crowdfunding platforms offer different conditions for raising money (and fees) and access to different groups of investors. Be sure to check out as many options as possible to choose the best and most beneficial one.

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Subsidies and Grants to Support Business Ventures:

EU and national funds are an advantageous but formalised source of financing business ideas. Operational programs offer many possibilities of financing and co-financing start-ups, and development of an existing company at various stages of its operation. You may apply for loans, microfinance and guarantees, or even equity financing, through publicly supported venture capital funds. Member country institutions determine the exact financing conditions- the amount; duration; interest rates; and fees. The table below outlines the advantages and disadvantages of using subsidies and grants:

Advantages	Disadvantages
• Several different funding programmes that you may be able to apply for, depending on the nature of your business and on the stage of your project. • You may apply for funds for various purposes from starting a business, through its development to acquisition and improvement of qualifications & competencies. • Provided that the conditions of the subsidy are met, the awarded grant amount is not refundable in whole or in a significant part. • In case of loans - reduced interest rates, larger financing volumes, smaller collateral requirements. • Almost no additional costs – sometimes the only expense is the cost of providing a deposit for a subsidy or grant.	• Public funds are often associated with formalities and necessity of keeping schedules.

Remember! Each European Union member is a beneficiary of structural funds and resources intended for the support and development of entrepreneurship and qualifications. Countries appoint institutions implementing and mediating the distribution of EU funds. Moreover, support is available either directly with EU grants, or through programmes managed at national level.

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Bank Loans and Leasing:

Bank loans and leasing are another type of external financing offered by financial institutions. Bank loans include, among others: investment loans (long-term, to purchase machinery and equipment), working capital loans (short-term, to finance liquidity) and payday loans (short-term, to finance company supplies).

Leasing companies offer various leases. Leases are contracts in which the asset owner allows another party to use the asset in exchange for something, usually money or other assets. The two most common types of leasing are operating and financing leases.

Experts emphasise that leasing is a more advantageous option for start-ups than bank loans, as both types of leasing increase liquidity of the company's current assets and leasing companies can negotiate a favourable asset price.

The table below outlines the advantages and disadvantages of bank loans and leasing contracts:

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Advantages	Disadvantages
• **Bank loans** • Are sometimes the only external source of money available. • Some banks or local institutions offer a government-backed loan. • **Leasing** • Usually lower interest rate than bank loans. • Payment schedules are more flexible than loan contracts. • In some countries after-tax costs may be lower due to tax rates potentially being different for the lessor and the lessee. • Leasing involves 100% financing of the price of the asset – own contribution is not necessary.	• **Both: bank loans and leasing** • Low creditworthiness may be a significant obstacle preventing you from receiving a loan or significantly increasing its cost. • Complicated and time-consuming procedures. • It is necessary to have collateral of a value comparable to the size of the loan. • Restrictive requirements concerning creditworthiness and rigid terms and conditions. • Only fixed assets may be financed through leasing.

Remember! Various banks and leasing companies offer different loan/leasing terms, restrictions, and requirements. It is crucial to check as many options as possible to choose the best and the most advantageous one.

Activity 1: Separate the fact from fiction (5-10 mins)

After reading the information about funding, decide whether the following statements are true or false:

Statement	True/False
1. The advantage of financing operations with your own financial resources is the flexibility and freedom to invest them.	

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2. The fundraising method known as 3F means raising money from firms, factories, and foundations.	
3. Raising funds through crowdfunding is cost-free.	
4. Leasing is a good source of financing for the purchase of fixed assets such as machinery or equipment.	

Breakdown of answers:

1. **True:** The use of one's own financial resources does not cause constraints connected with the necessity to comply with contracts made with external persons and institutions.
2. **False:** 3F stands for Family, Friends and Fools.
3. **False:** Raising funds through crowdfunding requires investment in the promotion of the project so that it is properly noticed by potential investors. Additionally, crowdfunding platforms charge commissions on funds raised from investors.
4. **True:** Leasing cannot be used to finance, for example, working capital.

Case Study 1: Use of own resources only

As a graphic designer, Celine worked for a company in the UK. She was very shocked one morning on arriving at work to find the company had fallen into insolvency, and she was to lose her job immediately. On returning home she did not know what to do, she was not eligible for unemployment benefits, and there were no jobs advertised for graphic designers. However, she had a computer with Graphic Design software, and she had contacts in her email address book. Celine set to work getting in touch with companies she had previously worked with, hoping for employment. By the end of her second day, she was offered work, but as a free-lance designer. Celine had started a business without even meaning to! From this contract Celine's new business grew rapidly, and within six months was international, as she gained contracts for Chinese companies exporting to Europe. She invested in a new computer and some office furniture once she became established.

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Case Study 2: Use of own resources and the loan from family

Steven moved from the UK to Greece to be with his girlfriend. He was a mechanic and thought it would be easy to get work in Greece, and this was the case until the economic crash in 2008. He lost his job at this time and there was no other well-paying work available, even for a qualified mechanic. Steven noticed that in Greece at this time more and more people were having to fix their own cars or motorbikes, but there was no spare parts or advice service available. In the UK there are many small shops and online retailers selling parts for cars. Steven borrowed €400 from his parents and set up a website selling spare parts which he sourced from Bulgaria. He publicised his service on Facebook, and gained new followers by making instruction videos showing how to do simple car maintenances tasks.

Case Study 3: Crowdfunding and grant

Hannah has an unusual skill; she spins and dyes yarn. She decided to turn this hobby into a business and initially planned to offer face to face workshops to groups of people interested in this craft. She needed limited investment at that point because she had a store of fleece she could use, and a lot of contacts. However, Covid-19 hit only three months after she started up, and she made the decision to move online. Hannah calculated that a €5000 investment would allow her to make high-quality instructional videos, buy special fleeces to mail out to participants, and build a more effective website where people could pay for their online courses; talk to her for advice; and buy the yarns she had spun herself. She offered people investing in her crowdfund cheaper courses, or limited-edition yarns, and exceeded her target amount of money by 100%. She also entered a competition organised by a bank which provided a €1000 grant for female entrepreneurs able to raise at least €2500 through crowdfunding.

Case Study 4: Financing with bank loan

James had never had a business before, but he was an experienced manager of care homes for the elderly with a lot of expert knowledge about the care sector. He saw that a local care home was for sale and felt he could make this into a viable business. A large amount of funding was needed – €400,000. He prepared a detailed business plan with the help of advisors at the Chamber of Commerce, and he took a short course at the local college to learn about pitching

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his idea. He took his plan to the bank and got the funding he needed. The assets of the acquired business (real estate) provided collateral for the loan.

Activity 2: Questions for cases 1-4

After reading the case studies above, decide whether the following statements are true or false:

Statement	True/False
1. In "Case Study 1: Use of own resources only", the use of only the entrepreneur's own financial resources enabled the business to quickly take off.	
2. In "Case Study 2: Use of own resources and the loan from family " the use of a bank loan would accelerate the entrepreneur's entry into a foreign market.	
3. In "Case Study 3: Crowdfunding and grant" with the funds from the crowdfunding, the entrepreneur was able to launch her business, while promoting her future business.	
4. In "Case Study 4: Financing with bank loan" - the entrepreneur was able to use a bank loan to start up his business, inter alia, because he took over an existing company whose assets provided security for the loan.	

Breakdown of answers:

1. **True:** Thanks to financing from own resources, the entrepreneur did not have to look for an external investor who would decide to finance the company and spend time applying for financing and waiting for its decision.

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2. **False:** Thanks to a loan from the family, the entrepreneur was able to launch the business quickly and did not have to spend time proving to investors (e.g. a bank) his knowledge of the foreign market or his creditworthiness.
3. **True:** The entrepreneur approached potential investors via a crowdfunding platform asking for their support but also informing them about the advantages of her company's offer. This had the additional effect of promoting it.
4. **True:** Collateral is required by the bank when granting a loan. Many of the start-ups do not have the necessary assets. The company described in Case Study 4 that was taken over by the new entrepreneur provided collateral.

Quiz: Check your understanding

Test your knowledge on funding.

- Which of the following points describes the characteristics of leasing:
  A. Used to finance the purchase of fixed assets
  B. Usually lower interest rate than bank loans
  C. Payment schedules are more flexible than loan contracts
  D. All of the above
- A source of financing that requires provision of collateral is:
  A. Bank loan
  B. Crowdfunding
  C. Own resources
  D. All of the above
- All business start-ups require bank loan financing:
  A. Yes, at least in 50% of the company capital
  B. Yes, at least in 20% of the company capital
  C. No, it is forbidden to use bank loan for start ups
  D. No, a bank loan may or may not be used by a start-up

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Breakdown of answers:

1. D - The characteristics of leasing as a source of financing include: the limitation of financing to fixed assets; the relatively low interest rate; and the relatively flexible payment schedules.

2. A - In the above-mentioned sources of financing, only the provision of collateral is required when taking out a bank loan.

3. D - There is no obligation for start-ups to use bank loans, to any extent.

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