Venture Financing

Starting a business: source of funds

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http://www.smecorp.gov.my

How much money do you need?

It depends on your type of business and how quickly you plan to expand. You should sit down and write out how much your expected expenses will be for at least the next 24 months and how much you project to bring in as far as income on a monthly basis. There are several companies that can help you get started with funding your business. You can refer back to your business plan or start asking yourself what type of expenses do you need the money for? Generally, for a start-up business, there will be a few costs involve:

- **Cost of sales:** Product inventory, raw materials, manufacturing equipment, shipping, packaging, shipping insurance, warehousing
- **Professional fees:** Setting up a legal structure for your business , trademarks, copyrights, patents, drafting partnership and non-disclosure agreements, attorney fees for ongoing consultation, retaining an accountant
- **Technology costs:** Computer hardware, computer software, printers, cell phones, PDAs, website development and maintenance, high-speed internet access, servers, security measures, IT consulting
- **Administrative costs:** Various types of business insurance, office supplies, licenses and permits, express shipping and postage, product packaging, parking, rent, utilities, phones, copier, fax machine, desks, chairs, filing cabinets – anything else you need to have on a daily basis to operate a business
- **Sales and marketing costs:** Printing of stationery, marketing materials, advertising, public relations, event or trade show attendance or sponsorship, trade association or chamber of commerce membership fees, travel and entertainment for client meetings, mailing or lead lists
- **Wages and benefits:** Employee salaries, payroll taxes, benefits, workers compensation

No matter what your business type, take into account everything you will spend, from the moment you dig in to the startup process, through the time you're ready to sell a product or service.

Where to get the money?

All businesses require some form of financing. The most basic rule in financing a business is to commit yourself and your savings or other resources to the business. This will ensure your whole hearted commitment to its success. This is also a strong sign of good faith and commitment for other potential lenders/investors as, if you are not seen to be willing to risk your own funds why anyone else should! Further, for a start-up business, there may not be a wide variety of sources of funds as it is still untested. Hence, you will have to come up with the capital, from personal savings or through selling off surplus assets you may have.

Personal saving

There's nothing like having your own money saved, to put into your startup. You have the satisfaction of having saved it on your own, and the knowledge that you don't owe anyone. When using your own money to finance a business, you will feel more personally invested in the project, because it is basically your money on the line. However, there is more flexibility in using your own money. For example, if your business is having a slow start, you do not need to worry about paying back a bank loan because you used your own money.

But the risk you may face is that - It's your money, and if you're not successful, the money is gone, and with it the opportunity to do anything else with it later. It can also create another financial burden. Most people have a savings account for general purposes. In other words, the money is not saved for any particular purpose and is used whenever it is needed for whatever reason. As such, draining such an account may negatively affect your financial situation if you need to dip into that savings account for an emergency. However, if the personal savings you use to finance a business was money saved for that particular purpose, you should not have any financial troubles as a result of the draining of that account. If your savings account was set up for the purpose of opening a business, this means that you planned ahead and reserved that savings account for that purpose only, and thus, will not feel the pinch in an emergency because you will have other funds available for that purpose.

Financing with debt

Financing a business with debt involves securing a loan. This can be in the form of either unsecured or secured debt. Unsecured debt refers to a loan taken without having to put up any specific form of security or collateral. This involves mainly borrowing from family or friends, a credit card, line of credit and other similar means.

Secured debt, on the other hand, refers to loans where you are required to put up some form of collateral in exchange for the loan, for example, mortgage on the house or refinancing your car, among others. For secured debts, you need to be able to assure the lender about your ability to meet your payments either through your business or other means. To secure such debt is some cases you will need to present a solid business plan, evidence of your experience and of your ability to repay.

Family and friends

Raising finance from family and friends can be rewarding for both parties: you get the finance to start or expand your business, while your family and friends have the satisfaction of helping you while earning interest on their spare cash. Family and friends may accept more flexible terms and conditions that are better suited to your business than those offered by commercial banks.

Often arrangements with family and friends are informal and based purely on trust and verbal assurances. However, a formal written agreement is strongly advised in order to minimise disputes in the future. Preserving your relationships with friends and family is as important as pursuing your business opportunity.

Personal loan

Financing a business with personal loans means that you borrow the money personally to invest it in your business. This is typically used at start-up or early stages where the business has not established enough history or performance to be able to secure a loan on its own merit.

Mortgage loan

Another source for financing a business is a home mortgage loan. Some banks allow you to mortgage or refinance your house. This may be a risky move as if you are unable to make the scheduled payments, you risk losing your home. It is therefore crucial that you are confident on your continued ability to make all payments scheduled.

Insurance loan

Another source of loan could be from your insurance policy. If you have been paying for a life insurance policy that builds up a cash value you are entitled to take up a loan on the cash value amount. Many insurance companies will loan you money with the cash value as security. This is a rather expensive method of financing a business and also means reduced benefits if you are unable to clear the loan and interests accrued.

Credit cards

Credit cards can also be a source for financing a business when you are first getting started. However, this is another expensive method as the rates charged can be high and it could also affect your credit rating, required for other sources of financing.

Government small business loans

There are a variety of government small business loans and programs that can be used in financing a business, including those specifically for Bumiputeras and micro entrepreneurs. Most of these loans are administered by the Financial Institutions like the Development Financial Institutions (DFIs) and the commercial banks. While some are directly administered by the department/agency involved. Funding from these sources may be relatively easier to secure as the government department/agency guarantees your loan, if you are approved.

Grants

There are often a variety of government grant programs for specific types of startup businesses. For more information, search online on government websites. Unless they're reputable, don't pay money to sites that tell you they'll give you a big list of where you can get grant money. The risk is that - While grants are rarely required to be paid back, accountability is higher, and you might have to work within a difficult deadline, to show your progress. If you do not achieve the progress you indicated in your proposal, there may be some sort of penalty.

Bank loans

Banks lend money to existing businesses but for a start-up, it may be very difficult to get a bank loan as they do not have a track record. Banks require a sound business plan and must be convinced of the viability of your business before they agree to lend you money. Banks also normally need collateral as security. If you have a solid business plan and the lender agrees, this can often be the cheapest (interest rate-wise) loan sources available. The risk is that besides the fact that it's often hard for a startup to qualify - since there's little evidence you'll be profitable - if you do get a loan, it can be like a ticking time bomb if your business isn't doing well.

Equity financing

Equity Financing is borrowing where the investor/financier becomes a part-owner of the business in the process. This could be through venture capital or issuing shares.

Venture capital

Venture capitalists do not want to remain in your business forever. Generally, they want to see an exit strategy that will see them out in about 5 years, with a high return on their investment as their reward. In terms of areas of interest, venture capitalists are interested in both high technology and various other industries. Normally they fund businesses which have already been launched and have probably reached profitability.

The angel investor, on the other hand, is a special type of venture capitalist. Usually an individual with substantial funds, the 'angel' provides capital to start-up companies and takes a personal stake in the venture. Depending on the individual 'angel', their requests for any form of control or a quick return on investment will differ. However, similar to regular venture capitalists, they seek high returns on their investment for the risks they take on.

Financing SMEs and entrepreneurs 2016

An OECD Scoreboard

Organisation for Economic Co-operation and Development

http://www.oecd.org

Financing for small and medium-sized enterprises (SMEs) has turned the corner from the downswing seen during the global financial crisis, but overall credit conditions remain challenging and access to external finance continues to be much tighter for SMEs than larger firms, according to a new OECD report.

Financing SMEs and Entrepreneurs 2016: An OECD Scoreboard underlines that SMEs remain over-reliant on bank financing and points out the need for a diversification of financing sources and instruments. The Scoreboard provides comprehensive data on debt, equity, asset-based finance, solvency and the framework conditions for SMEs and entrepreneurs, along with an overview of policy measures to ease SMEs' access to finance in 37 countries. The OECD presented the report to G20 Finance Ministers and Central Bank Governors in Washington as part of wider discussions on developing policies to boost diversification of financing instruments, a key priority of China's G20 Presidency.

"Finance is one of the keys for unlocking the potential of small firms to innovate, upgrade and become more productive," OECD Secretary-General Angel Gurría said during a presentation of the Scoreboard with Zhou Xiaochuan, Governor of the People's Bank of China, just prior to the G20 Finance Ministers meeting on 14-15 April in Washington. "The OECD's new SME Scoreboard shows that while access and conditions to traditional credit for SMEs have improved since the worst point of the global economic crisis, governments can and should do more to tackle the longstanding obstacles to SME financing," Mr Gurría said.

Governor Zhou said: "SMEs and entrepreneurs can play an active role in achieving stronger and more inclusive growth, and it is now time to show our commitment to enabling the development of alternative funding options." He welcomed the new OECD Scoreboard, which he said would support efforts to develop policy recommendations on diversified financing for SMEs during China's G20 Presidency. "The OECD Scoreboard is a valuable tool to support G20 work, and to monitor trends and the implications of financial reforms for small and medium-sized enterprises."

The fifth annual edition of the OECD Scoreboard highlights developments in SME financing over the 2012-14 period. On the positive side, it shows that the outstanding stock of SME loans rose in 16 out of 27 countries, and new lending in 2014 surpassed 2013 levels in most countries. Similarly, credit conditions eased and interest rates on new loans to SMEs declined in 2014 in the majority of countries studied.

On the negative side, the interest rate spread between loans to SMEs and those to larger firms continued widening. This suggests that the risk perception of SME lending has increased over time. This perception appears out of synch with new data showing a clear downward trend in SME bankruptcies, which declined during 2014 in 20 out of 25 countries for which full data was available.

A special chapter in this year's Scoreboard focuses on how so-called Business Angel investors can help bridge the financing gaps for firms with high risk-return profiles during the early stages of development, and notes their importance in providing business advice, mentoring and networking opportunities. It also underlines the need to improve the evidence base to enable a better understanding of the potential of Business Angel investment to finance SMEs, and support the design of appropriate policy making.

Highlights

- Lending to SMEs improved in 2014. For most OECD countries, economic growth increased between 2012 and 2014, and financial conditions were overall favourable in the majority of participating countries, impacting SME lending favourably.
- Credit conditions generally eased in 2014, but remain overall challenging for many SMEs.
- The interest rate spread remained positive for all participating countries over the entire 2007-14 period, with SMEs consistently facing higher average interest rates for loans than large firms.
- SME bankruptcies showed a clear downward trend in contrast to previous years.
- Recent trends in non-performing loans (NPLs) are mixed, and NPLs could pose a threat to the economic recovery in some economies.
- Venture capital (VC) investments and leasing volumes showed encouraging signs of recovery, but remain below pre-crisis levels in most countries.
- The use of some alternative financial instruments continues to grow, but often from a small base.
- Evidence suggests that business angel investing plays an important role in financing young, innovative and high-growth firms.
- Loan guarantees remain the most widely used policy instrument used by governments to facilitate SME access to finance.
- SME finance remains high on the political agenda, and governments are developing new policy initiatives.