TRANSITION Project

The Business Plan. Identifying your financial and non-financial requirements and how to address them

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➢ The business plan: a tool for gaining financial (and other) support

The formalization of a strategy is crucial not only for large companies, but even more for startups that may need to explain and communicate the strategy that they intend to follow, formalizing it through a solid business plan in order to present their project to the stakeholders, like potential partners or investors.
In general, a business plan can be defined as a document which represents the end result of the planning process.
More precisely, the business plan is a written report that illustrates the strategic plan of the startup in the medium to long-term (three to five years), clarifying the competitive objectives - in terms of sales volume, market share, position in the various segments - and financial objectives - in terms of profitability - as well as describing the corresponding actions the company is willing to implement to achieve these objectives. All the latter are expressed both qualitatively and quantitatively.

Newly born SMEs usually write a business plan to take contact with external parties: potential resource providers or business partners. This is because they need to find investors to implement first ideas and build a network to make the business sustainable.
Secondly, the "internal" function of the business plan has an essential value for a start-up. It allows the entrepreneurial growth of the team by increasing the awareness of risk and forcing the transition from the idea to the company.

The importance of a business plan for startups is clarified by an important research published by the Journal “Small Business Economics" in 2011. According to the research, startups that define their scope of action according to the standards set by a business plan are up to 150% more likely to turn the project into a business. Moreover, the article explains that companies operating with an inadequate business plan, if they achieve the same objective, take twice as long as companies led by a preventive business plan.

It is now crucial to understand how to build a solid business plan.

It must be specified that, as far as business plan models are concerned, a “one size fits all” model does not exist. However, here is presented a scheme that both startups and mature firms could benefit from.

Usually, the business plan starts with an introductory section that summarizes the essential contents of the plan (*executive summary*), followed by a second section which analyses the strategy implemented to date by the company (*strategy overview*). A third section contains considerations with regard to exogenous and endogenous variables which may or may not require a strategic change (*internal and external analysis*), a fourth section presents the strategic plan for the future and the goals to be achieved (*strategic objectives*), and finally, a fifth section details the plans of action (*action plans*) necessary to achieve these objectives within a fixed time. The plan is concluded with a final section that translates the strategy described into the economic-financial projections which define the yearly goals the company intends to achieve, in terms of growth and profitability, and cash flows generated over that period.

The *executive summary* describes the features and elements that explain and justify the "business opportunity", how to implement it and the results that are expected to be obtained.

In the *strategy overview* the firm should explain the strategy realized so far. Obviously, in case of a new created startup this part will be skipped.

In the third part the startup should make both an *internal and external analysis.*

- Internal analysis: the startup should think on the internal resources and competencies that the startup has in comparison with competitors.
- external analysis: the startup should focus on the risks and opportunities come from the competitive environment.

The section dedicated to *strategic objectives* should contain vision, mission and a strategic pattern consistent with them.

The fifth section, action plans, should summarize actions, timing, organizational responsibilities, economic and financial impact and problems and constraints concerning the individual actions to be taken soon.

Provided that all sections are important, for startups the most difficult task to perform is mostly translating the corporate strategy in financial terms (final section). It often happens, in fact, that there is little certainty about the product/service to offer, just as the market response is uncertain. In addition, by offering an innovative service/product, there is often no data that can be relied upon for a good analysis.
So, in an innovative startup the idea is constantly evolving and needs testing and evaluation before we can go into the drafting of a complete a Business Plan.

To drawing up the last part of business plan and explain the operational performance of the startup is useful to know some financial notions. The most common used indicators of operating performance are EBITDA and EBIT.

The acronym EBITDA stands for Earnings Before Interest, Taxes, Depreciation and Amortization, while EBIT stands for Earnings Before Interest and Taxes and is derived from the first one (by subtracting depreciation and any effects of devaluation or extraordinary items). EBITDA is a margin of profitability that measures a company's profit before interest, taxes, extraordinary items, depreciation, and amortization. It expresses the true operational result of a company's business. The EBIT is an indicator that is affected by fiscal policies, particularly regarding depreciation. During closing of accounts, at the end of a period, the business can legitimately decide to apply different depreciation policies, although they will produce different effects on the final balance sheet data.

Whitepaper: the blockchain equivalent of a business plan

The White Paper is a document that companies use to present their project based on blockchain to the public, describing its features, usefulness, advantages, etc. It is published when an Initial Coin Offering (see subchapter "A*lternative finance"*) is launched.

This document not only explains the technical application of the project but also presents the team and the objectives to be achieved. The structure of a white paper is usually similar but not identical to a business plan. A white paper is defined as a non-standardized information document but has usually these sections:

- Introduction
- Presentation of the Team
- Problem Definition and Solutions
- Project description
- Economic advantages
- Crowdsale details (the amount the company asks for financing its project)
- Conclusion.

➢ Get your hands dirty

What is the basic idea for the new product or service?

It is important to stress that there are many variables that affect more or less the future business. The controllable by the entrepreneur variables but also conditioned by the institutional context are the following: business opportunity, market, resources and strategy. Creation of a new business is based on the identification of a business opportunity which is a starting point. Resources, that include material and non-material and human resources, are needed for development and exploitation of a business opportunity. Besides that, the firm should know where it will operate - on which market or segment or niche – and if it will be profitable and good for the business. This is related to the strategy the entrepreneur will adopt for an adequate combination of the means of production and the way to address the potential customers / consumers or users. The relation between the objectives and tools helps to define the business idea and exploitation of the business opportunity. The entrepreneur, motivated, skilled and well prepared, is a central figure who must make adequate decisions on the basis of the above-mentioned elements.

What is the opportunity being developed?

The entrepreneur creates new ventures which is very important for the economic development of the country because it means creation of new jobs, establishment of new economic relations and so on. It also affects the process of allocation of resources, determines the business dynamics and produces an industrial network called business density of a region or a country. New ventures are a sap of the market economy system. A healthy balanced industrial structure assumes that new companies enter the market and at the same time there are other companies that, due to various reasons, abandon it. So, the replacement rate should be maintained within proper limits to ensure a balanced circular flow of incomes. Besides that, social, cultural and political contexts benefit from new businesses in the market because they provide a positive impact to the national economic development resulting not only in new jobs, but also in new uses of financial markets and management in general, require formulation of new laws and contribute to education and culture.

Why is the product useful or appealing, and to whom?

Market research is necessary to obtain the correct information about the customers, competition, and general environment, so that the entrepreneur can decide whether the production and selling of a new product or a new service represents potential growth. Any action made in this regard, which is not grounded on a prior market research, will likely result in a failure.

Market research is the process of collecting, recording, and analyzing data which interpretation serves to estimate opportunities and threats of any market. It is a frequently used tool when we want to launch (or relaunch) a product or service and for this we need to measure consumers' behavior and attitudes.

The goal of market research is to help an organization achieve its business objectives by providing fact-based analysis of what consumers desire or need, or their purchase power, avoiding intuition and emotion from the decision-making process. This is a rational manner to estimate the starting point and reduce business risks.

Our market study, or research project, should always begin with defining the problem or opportunity to be studied. Frequently we used to focus on symptoms, which are manifestations of something hidden, something that causes what we observe. After the problem definition we need to set key objectives of the study and decide the most appropriate techniques and methods to gather data and what sample to use in our study.

There are two methods widely used in market research, both individually and conjointly:

1) **Secondary Research**. It is used to collect information from existing sources. For example, statistics, documentation centers, databases, or panels on certain groups of products or brands. The organizations that offer this information are either governmental entities (Eurostat, OECD, IMF, UN, GATT, SMEs Institute, etc.) or private companies that carry out different kinds of full market studies or only offer their specific services in some of the analysis or tasks, like field services, analytical services or reporting, among others (Thomson Reuters, Nielson, Kantar). Some of these secondary sources are available online for free, for example, databases offered by the World Bank, OECD or IMF or recent surveys on different specific topics. In every EU country there is always at least one organization that officially provides with the latest statistics regarding economic, financial, and social development of its nation. We can also add specific journals or publications through which we can carry out a documentary analysis (Harvard Business Review, Forbes, AMA Publications, McKinsey Quarterly, etc.).
   Secondary information must be very reliable, so, it is important to evaluate the experiences, credibility and reputation of the organizations that offers us the data, for which frequently we must pay. Secondary source is especially helpful to identify the problem, develop an approach to the problem and the sampling plan and design properly the research. They also help to respond certain questions of the study and test the hypothesis. However, there are some drawbacks related to secondary information, such as the possibility that it can be biased and obsolete or that it is difficult to adapt to the specific needs of the company.

2) **Primary Research**. It is used when the information obtained from secondary sources is not enough, since the company needs to investigate specific problems and situations. So, it must generate its own research, which is usually costly and takes longer time. This is due to the processes of data collection, which is complex for primary information and consumes much time and resources. So, such factors as time and money will influence greatly on the way the primary research will be carried out.

Combining primary and secondary sources of information we can obtain better results, but the proportion of each type of research will depend on the budget and time restrictions.

The market research's main aim is to find out the new needs and desires for products or services, and to create these products or services. For a successful business, the entrepreneur needs to consider the following points:

1) Have a product or service demanded by a customer.
2) Provide this product or service better than a competitor
3) Charge a price that offers value to the customer yet enables the business to earn a profit.

How will the idea be realised?

Entrepreneurs need the initial capital. Entrepreneurs, when they start with their idea, need to identify what is necessary to have to start their businesses. That is, what are the financial needs for a start-up. For this it is important to be familiar with some basic economic concepts that help to clarify crucial questions related to money needed for a project.

The cost of Equity and Liabilities (loans) is called weighted average cost of capital. A combination of the two sources of finance provides an optimal way to raise funds and build a business.

The first step to obtain financing is to establish the financing needs of the company in *amount* and *timing* and to set what is the amount designated for each company area.

A fundamental condition when planning any investment is to correctly calculate its *amount* and *timing*, since any mistake in any of these two parameters will consequently increase the project's costs, which will have a direct impact on the profits.

Calculating an excessive *amount* will make the entrepreneurs solve the following questions: the source of financing (internal or external) and assessing of the opportunity cost (it won't be possible to use additional funds for other investments). If financing is made through external sources (usually through a bank), the investment will mean a larger operational cost because of the interests.

Regarding *timing*, the effects are exactly the same as the ones related to the *amoun*t. An opportunity cost will happen if the investment timing with own resources is excessively extended; and the costs will rise by paying interests in excess if the duration of the external financing source (through a bank) is extended more than of what is really needed.

Also, it is essential to correctly set the amount of interests that corresponds to each part or area of the project. An incorrect investment distribution among the different departments or project areas will be the result of a financial mismanagement and the prelude to more problems in this area, as well as to the project's proper operation and its mid-term and long-term viability.

What is the overall plan for developing the product / service, for marketing it, for dealing with current and future competition?

Marketing plan, or strategy, explains how the business will market and sell its product or service. It should analyze price, promotion, distribution, and sales. It is not enough to have a full understanding of the customers and competitors but not to find the customers who will buy the products and services produced by the company. It is necessary to describe the company's marketing strategy, positioning and points of differentiation, and explain how this plan will be supported by the price, promotional mix and sales process and distribution strategy. So, price, promotion and distribution must be aligned with the company's positioning and points of differentiation.

Price is critical since it will determine eventual revenues and profits of the company. It also contains an important message for the target market related to the quality of the products and services the company plans to offer its customers. This section must include information about the sales cycle and sales techniques the company will employ and also a plan for advertising and promotion. The sales plan should explain service and warranty policies that may also include training. At this point, it is necessary to provide the description of the method to manage service problems and who will provide after-sales service (the company itself or agencies or distributors and so on).

This part will generate additional costs that should be considered for the economics of the business. It is also recommendable to compare the proposed terms for service with those of the competitors. Regarding advertising and promotion, it is necessary to describe the approaches the company will use to get closer to its potential customers. The entrepreneur can include a plan for trade show participation, advertisements, direct mailing, preparation of product flyers, promotional literature or use of professional agencies. These actions also generate costs that must be included within the general indirect costs (remember, these costs will influence the operational margins).

Product Design and Development Plan should contain information about the development efforts, especially when the business is new and new products and services must be designed and produced. It sheds light on the extent of the design and development phase that will require money and time before the product or service is marketable. That is why details are needed to understand the process itself and the incurred costs. It is important to point out at which stage the product or service is situated at this moment: product conception, prototyping (the first physical manifestation of a new product, it can also be virtually generated), initial production or full production.

This part should also include the competence or expertise the company has now or will need to guarantee the product or service development. It may happen that any customer is collaborating in this development or testing, if this is the case, then the results, achieved or expected, must be indicated in the business plan too.

It is also necessary to describe the company's *products and services* and highlight the features (a descriptive fact about the product or service) and the unique characteristics compared to the competitors. If there are patents, trademarks, or copyrights, they must be cited in this part as protection of the product. Another important detail is the benefit that the customers will obtain by buying the product or service of the company. This part must clearly show the products and services' position in the market.

It is also recommendable to include a short *status section* indicating the milestones (significant events) achieved by the company. For newly created companies, for example, it is important to state that the company's name is already selected and registered or that a feasibility analysis is completed. And finally, include information about *key partnerships* which is also critical for the business viability since this is the force that makes the business work efficiently.

Industry Analysis includes information about the industry/sector in which the company will operate or has been already operating, for example, a toy industry or children's clothing industry. This is the environment in which the company competes too. The information about the industry comprises main updated data regarding its size, growth rate, new attractive areas, vulnerabilities, sales projections, trends, and emerging developments. We need to see whether the business industry is concentrated (dominated by a few large corporations) or fragmented to understand if the entry barriers are strong (for concentrated industries) or weak (for fragmented industries). The nature of industry participants is also worthy highlighting. They may be innovative or conservative, proactive or reactive and so on. Another element to include in this section is the key success factors (usually up to ten factors) since they define the frame for competence. Trends within the industry must refer to environmental and business trends. Environmental trends comprise economic, social, technological advances and political and regulatory changes. Business trends refer to the evolution of profit margins in the industry and to the input costs that determine the product strategy of a company. It is also recommendable to include a brief statement of the company's beliefs regarding the long-term projection for the industry.

Market analysis to understand the market dynamics and issues

Market Analysis is different from the industry analysis. Market analysis focuses on the industry's segments and tries to identify the company's target market. The technique generally used for such purpose is market segmentation that employs different dimensions such as geography, demographic variables, or psychographic variables and so on. The target market must be attractive, the goal is that the company should be uniquely capable of serving to the selected target market. At this point it is relevant to include information about how the customers of this market behave since this will enable the company to adapt to their specific needs. Usually newly created firms or start-ups target a niche market instead of an entire segment since the latter is large and may present certain difficulties at the beginning. A niche market is easier to penetrate since it is only a part of a segment and represents a narrow group of customers.

Market analysis also includes a detailed *competitor analysis* that should focus on key competitors, their strengths and weaknesses, their strategies, the position in the market and so on. Moreover, it must explain how the chosen business strategy position the company against the competitors. The next step is to craft a unique market position. And finally, it should include the estimation of annual sales made on sound assumptions. This will indicate the market share that the company plans to obtain. For sales estimation there are various methods that can be used, for example, determining the number of customers the company expects to sell to and the average amount each customer will spend ("the average ticket"). It is also possible to build sales estimation through a comparable company or contacting Industry Trade Associations or carrying out an internal search, usually through Internet.

Who are your partner entrepreneurs? Is there a management team?

The part of Management Team and Company Structure provides information about the strength of the people of the company. The management team must be prepared to implement the business idea and one team can be prepared better than another one for the same task. This information must illustrate the qualification of each member of the team and include the title of the position, duties and responsibilities of the person, his/her experience, previous successes and educational background. It is advisable to include a graphic representation of authority and responsibility distribution within the company through an organizational chart.

If needed, this section can include information about a board of directors (a panel of individuals elected by a corporation's shareholders to oversee the management of the company, with legal responsibility for the firm) and advisors (a panel of experts asked by a firm's management to provide counsel and advice on an ongoing basis, no legal responsibility for the firm).

Do they have the required knowledge, experience, skills, contacts and energy to develop this idea and run a new company?

When you want to start up your own company, with whom do you team up? It is normal for you to team up with those near to you. Many business projects arise from talks in a bar or while having a coffee in the hall of an office. Not a bad start but behold.

A successful entrepreneur must be able to delegate tasks to employees and team members, but to do it, firstly, it is essential to build a reliable management team. Not having a good team is indeed one of the classical mistakes that first-time entrepreneurs make.
An entrepreneur must not focus on the individual, but on the team, and, ultimately, on the result.

A well-constructed team is made of people who have different attitudes, competences and skills. The employees of a solid firm should at least have the following competences:

- Financial management: having a good grasp of cash flow planning, credit management and maintaining good relationship with banks and accountants.
- Product development: making long-term plans for your products or services and identifying the people, materials and processes required to achieve them; knowing your competition and your customers' needs.
- People management: managing recruitment, resolving disputes, motivating staff and managing training; helping employees working together as a team.
- Supplier relationship: identifying reliable partners, successfully negotiating with them and managing relationship.
- Sales: identifying potential customers and their individual needs, explaining your goods and services effectively and converting potential customers into clients.

Moreover, an entrepreneur should keep in mind the following in order to have an effective relationship with his team:

- Not to give the loyalty of colleagues and friends for granted. Many entrepreneurs blindly rely on their partners and have no doubt that they will be loyal. But the enterprise cemetery is full of examples of companies that ultimately came to a negative end due to disagreements between partners.

- Be careful with the "I will do it" attitude. An entrepreneur must not think in terms of individuals, but as a team, and, ultimately, focus on the end result. It is important to refute two lies: 1. the initial team is a pillar that will be there forever; and 2. that investing in the team is simple. It is not easy to find talent, nor is it easy to keep it.

Things you should not believe if you are an entrepreneur (2017). Retrieved from (original source in Spanish): http://www.emprendedores.es/crear-una-empresa/cosas-que-no-debes-creer-falacias-joven-emprendedor

How will the venture be structured and how will it operate once launched?

It is intended for the internal stakeholders and is especially recommended for established businesses. It is an extended document with a great number of details that serves as a guide for operational managers. It explains how the business will be run and how the products or services will be produced. A brief version of this plan is recommended for a new business: it is usually included in the Full Business Plan providing a general approach to operations and a breakdown of activities that are seen (front stage) and that are not seen by the customer (back stage). The geographic location of the business may be considered crucial for operations, so, it should be explained then in details. Facilities and equipment is another important part to be included in this section. They constitute the company's assets, so, they must be described in terms of available funds for their acquisition and advantages they offer.

How much funding is needed? What type of funding? How will it be used?

Financial Projections is the final formal section of a full business plan. It is based on the previous sections, that is, all the information included in the plan must be translated into financial terms. First, it is important to outline the sources of funds statement that includes the following information: how much money is needed, where they will come from and how they will be used. An assumption sheet is another item to include in the plan. It must explain the most critical assumptions on which the financial statements are based (for example, the national economy growth, more incoming foreign capital is expected in the country, decrease of corporate taxes, growth of any particular industry and so on).

The financial projected reports included in this section are income statement, balance sheet and cash flow, the same financial and economic reports used in any existing business, but, when projected for the future, they are called as "pro forma". Pro forma cash flow statement is probably the most consulted financial report of the business plan since it shows when the money is available to pay the investors back. Pro forma income statement is a plan-for-profit plan of financial management which indicates the potential financial feasibility of the company. Pro forma *balance sheet* details the assets required to support the projected level of operations. Liabilities is another part that completes the balance sheet report that shows how the assets must be financed. In this report it is important to understand whether debt-to-equity ratios, working capital, current ratios, inventory turnover and other indicators are within healthy limits.

The recommendation is to develop the forecasts for optimistic and pessimistic scenarios and trace several years of projection, this facilitates a global comprehension of a business growth. These statements can be completed with ratio analysis (for example, returns on assets, returns on equity, and returns on sales) since they express the potential of the business.

How will the entrepreneurs (and investors) realise a return?

The part of **Economics of the Business** starts with the financial analysis of a business. It should explain how profits will be earned. So, the information such as *break-even point* or *margins* (gross and operative) together with other relevant ratios must be determined and included in this section as the main indicators.

It is possible to compute gross margins, for example, if the company estimated correctly the costs of goods sold which are the materials and direct labor costs needed to produce these goods. Gross margin is the difference between the revenue (what is sold) and costs of goods. It is also called *contribution margin*, since this amount contributes to a profit generation. The break-even point (X) - the revenues needed to cover a company's total amount of fixed and variable expenses during a specified period of time - is computed through sales price per unit (S), fixed costs thought the specified period (C_F) – the costs a company incurs regardless sales are produced or not - and variable costs per unit (C_V) – costs that depend directly on sales:

$$X = \frac{C_F}{S - C_V}$$

According to this formula, we will obtain the unit number that the company must produce to break even. The information about the costs is also necessary to determine a company's operating leverage. Operating leverage is highest in companies that have a high proportion of fixed costs relative to their variable costs and lowest when this proportion is low. It means that a company with a high operating leverage takes longer to reach break-even; however, once break-even is reached, more profit can be earned.

For a company that should be legally constituted, it is necessary to include the initial expenditures that will not be repeated every year. They usually include legal expenses, fees for business licenses and permits, website design, business logo design and similar one-time expenses.

Financial Plans and Projections

Capital required – start-up costs

Entrepreneurs need the initial capital. Entrepreneurs, when they start with their idea, need to identify what is necessary to have to start their businesses. That is, what are the financial needs for a start-up. For this it is important to be familiar with some basic economic concepts that help to clarify crucial questions related to money needed for a project. So, entrepreneurs should estimate the following aspects to start operating:

- **Investments sum.** This is typically a list of initial investments, for example, product development or pre-operating costs. The list should be detailed since the total sum will indicate how much money, or capital, is needed to cover this part.
- **Sum of all costs.** They refer to the forecast of the costs generated during the first year. It is advisable to think that the business will not obtain all the projected revenue. It is frequently assumed that initially a company will generate losses rather than profits and consume financial resources.
- **Taxes.** A fiscal concept is also very important in the economic model of any country. Companies must meet their different fiscal requirements, such as VAT (usually declared quarterly), corporate tax (applied to the profit obtained by the company at the end of the fiscal year) and social security that includes a percentage of the salaries of the hired staff (paid monthly).
- **Cash flow**. It means that an entrepreneur must present the forecast in terms of availability of money. For example, the goods delivered by the providers must be paid in June and the production will be finished in July, so, sales will be possible from July onwards. It means that the first incomes will probably happen in August or September. Meanwhile the entrepreneur must cover other expenses for energy and water supply or wages of the hired personnel. This topic will be explained in detail furthermore.

The cost of Equity and Liabilities (loans) is called weighted average cost of capital (further on there are more details and an example illustrating the concept). A combination of the two sources of finance provides an optimal way to raise funds and build a business.

The first step to obtain financing is to establish the financing needs of the company in *amount* and *timing* and to set what is the amount designated for each company area.

A fundamental condition when planning any investment is to correctly calculate its *amount* and *timing*, since any mistake in any of these two parameters will consequently increase the project's costs, which will have a direct impact on the profits.

Calculating an excessive *amount* will make the entrepreneurs solve the following questions: the source of financing (internal or external) and assessing of the opportunity cost (it will not be possible to use additional funds for other investments). If financing is made through external sources (usually through a bank), the investment will mean a larger operational cost because of the interests.

Regarding *timing*, the effects are the same as the ones related to the *amoun*t. An opportunity cost will happen if the investment timing with own resources is excessively extended; and the costs will rise by paying interests in excess if the duration of the external financing source (through a bank) is extended more than of what is really needed.

Also, it is essential to correctly set the amount of interests that corresponds to each part or area of the project. An incorrect investment distribution among the different departments or project areas will be the result of a financial mismanagement and the prelude to more problems in this area, as well as to the project's proper operation and its mid-term and long-term viability.

Additionally, it is fundamental to correctly calculate the effective cost of the resources that are destinated for financing the investments to be made in a project.

It is frequent, above all in the external financing sources (bank), that entrepreneurs do not take into account all the expenses of the total or effective operating costs. As a consequence, in many occasions, the costs of a financing operation are considered, which are much lower than the real ones with the resulting surprise when one checks that what was calculated is much below the real costs. This, of course, compromises the correct achievement of the investment.

In this regard, it is advisable to pay attention to all the conditions, not only to those related to the loan, but also to the relationship between the company and the bank, so that the enterprise to get the loan. Not only the interest rates applied to the granted financing will have to be taken into account, but also the rest of associated expenses, which will vary according to the granted financing (mortgage loan, personal loan, credit account, trade discount, leasing, etc.).

So, depending on the obtained financing, we will have to pay attention to expenses such as opening fee, cancellation fee, appraisal costs (in mortgage loans), information expenses, cost effect (in trade discount), non-disposition fee (in credit accounts), notary fees, mortgage arrangement fee, notary costs related to the bank overdraft, the maintenance costs, etc. The sum of all those expenses will result in the operation's real or effective cost, which a rational base for deciding whether the operation continues or not due to excessive costs.

Fixed assets required – buildings, equipment, patents, other

Tangible fixed assets refer to physical property and include real estate and movable property in their net values. The elements that constitute permanent, or fixed assets are the following: a building, land, equipment, machinery, furniture, vehicles and so on. These assets generate depreciation which is the expensing of fixed assets over its useful life. Since tangible assets might have some value at the end of their life, depreciation is calculated by subtracting the asset's salvage value or resale value from its original cost. The difference is depreciated evenly over the years of the expected life of the asset. In other words, the depreciated amount expensed in each year is a tax deduction for the company until the useful life of the asset has expired.

Intangible fixed assets are not physical in nature and include patents, brands, goodwill, copyrights, franchise agreement or intellectual property. These assets generate amortization which spreads an intangible asset's cost over that asset's useful life. Amortization is typically expensed on the same amount each period over the asset's useful life. Assets that are expensed using the amortization method typically don't have any resale or salvage value, unlike with depreciation.

Both tangible and intangible fixed assets reflect capital (illiquid) investments. This is what a company invested in to produce products or services and obtain certain profit. They cannot feasibly be turned into cash like current assets.

Current assets reflect the value of all assets that can reasonably expect to be converted into cash within one year. They include, in net values, raw materials and manufactured products (usually referred to as inventory), cash and cash equivalents, accounts receivable (customers who will pay in the nearest future according to the outstanding invoices), marketable securities (short-term investments), prepaid expenses and other liquid assets that can be readily converted to cash.

Equity, as it was explained in the previous chapters, includes the owners' capital and retained profits as well as eventual non-refundable subsidizes. That is, the finance which is considered internal.

A bad financial situation for the firm is considered when there are plenty of liabilities in short term and little liquidity of the assets. It is always difficult to transform fast the assets in money in short term. So, it is advisable to keep the current assets higher than the current liabilities, which means that there will be no problems with payments in short term. It is also advisable to have abundant net equity regarding liabilities (the basic idea is that it is better to owe to the shareholders than to the external parties).

The owners' equity plus long-term, or fixed, liabilities are called permanent capitals which must be sufficient to cover fixed assets. Another consideration is working capital which is the differences between current assets and liabilities. Working capital ideally should be positive to guarantee that the company can operate successfully.

For a start-up or a newly created venture it will be difficult to raise capital through one single source, but it will be easier to use simultaneously different financing sources. This practice is known as layered financing, a method of raising capital from multiple sources, that provides better results.

Working capital requirements (based on salaries, stocks, research, marketing)

Short-term resources are mainly obtained through external funding (banks and providers), although some of the company's own resources can be also short-term oriented. Short-term finance is used to replenish the working capital to purchase inventory or finance credit sales to customers or increase cash at certain moments. When inventory and receivables are converted into cash, the loan is repaid.

Short-term resources can arise, as we said before, from the providers (called "trade credits"), when the payment terms agreed with them include deferred payment, for example, 30, 60 or 90 days after the goods' delivery. It can also come from banks if we carry out operations of trade discount of letters, promissory notes and invoices (these funding models will be discussed later).

As any other business, start-ups should think strategically on what they want to achieve, since capital raising is not about collecting as much as possible but about covering the specific financing needs detected previously through a dedicated analysis. So, they will need a strategic plan that they would present to their potential investors. They will invest if they consider the business attractive and profitable, but then they would be interested in obtaining their initial disbursement and profits (returns on investment). So, it is necessary to speak about the terms here: when, under what conditions, what amount of money, and so on. This is what is called an exit strategy.

Working capital is the differences between current assets and liabilities. Working capital ideally should be positive to guarantee that the company can operate successfully.

Working capital is thus the amount of current assets in the firm that are not financed by current liabilities. It is a measure of a company's short-term financial fitness as well as its efficiency. Positive working capital shows that a firm can pay off its short-term liabilities, which is important for a financial balance of a firm. But bear in mind that it is possible to have a positive working capital and still be unable to handle a large, unexpected cash need. Negative working capital shows that a firm is currently unable to offset its short-term liabilities with its current assets. This is a synonym of financial difficulties; bankruptcy is the most severe.

Working capital must be enough to keep the stock level of raw material, of products under production and of finished products to attend the demand. Besides that, it provides appropriate credit-time to the customers according to the established collection period.

Cash flow forecasts showing expected revenue and costs

The firm must generate enough cash flow to sustain the debt payments.

The Anglo-Saxons say that "cash is the king". This means that the most important aspect for firms and startups is liquidity. A solid firm is a liquid firm because debts are repaid not with profitability or equity, but with cash. In fact, a debt can be seen as a cash loan that has to be returned to the bank in form of cash.
In other words, a firm must generate cash flows in order to be eligible for financing, because only a firm that generates cash flows is able to repay the debt.

The statement of CASH FLOW is the third of the major financial reports: it includes Balance Sheet and Income Statement.

If all costs and revenues were paid in cash, there would be no need to make a cash flow statement. However, the balance sheet does not follow this logic: reading the balance sheet alone you may see that the firm has obtained revenues for one million more, but this could mean that the firm has credits for 1 million. However, the clients have not paid it yet and they may not do it in the near future either. The Cash Flow Statement is therefore used to match the cash flow logic with the balance sheet figures.

In particular, Cash Flow Statement is going to indicate how our cash is evolving, either it is getting increased or decreased throughout the year. The whole purpose of this report is to assess the health of our cash balance and plan the future operations.

Cash Flow Statement is a dynamic picture of the company's finances. It is a statement that shows growth or reduction of liquidity through cash flows generated in any business area, in other words, it shows us the available funds and its past and future variations.

Cash flow shows the company's capability for generating liquidity and the related financial balance. The statement can be represented in two different ways: direct and indirect. Both are explained in the chapter. Furthermore, there are some useful tips from experts' recommendations to manage cash flow.

Many managers confirm that cash flow statement is the most important report because it indicates whether the planned operations can be carried out safely or not. For financial managers it is crucial since they can know the company's financial needs and plan a financial strategy accordingly. We must take into consideration payments (remember that this is our responsibility to pay back our debts, otherwise the providers stop supplying us with the material and, what is worse, they will claim it judicially which damages the company's image in the market), receivable collected from customers and also eventual investments needed for the future growth.

We will see that cash flow statement is broken into three categories, as follows, and a final summary section:

1) Cash flow from operating activities.
2) Cash flow from investing activities.
3) Cash flow from financing activities.

The final summary section shows **NET cash flow**.

Available cash is determined through the resources owned by the organization and the economic requirements that must be addressed to ensure its activity. A basic formula is the following: CASH = RESOURCES – NEEDS.

Treasury is a liquid asset to be managed as other working capital assets. An efficient treasury makes the company independent from additional financial resources (banks, suppliers, etc.).

It is always crucial for any organization to predict and control the inflow and outflow of money and their impact on the business, this is what shows its financial health. What determines whether the business can continue or not is cash, not sale?

As we indicated in the previous section, if the concept of funds is interpreted in its simplest meaning, which is availability, the Statement of Source and Application of Funds would be equivalent to the Statement of Source of Cash and its Application or the Statement of Cash flow.

We must foresee all the movements of cash and detect its availability or lack. We will try to record all these movements 'ex-post', that is, by the end of each period, so that we will obtain a planning at a rather high level of approximation, although not with total exactness.

The variations of the availability will be caused by:

- ∉ **Increase:**
  - ↓ Collections derived from the operation,
  - ↓ Collections derived from increase in the capital,
  - ↓ Collections derived from the new long term and short-term debts,
  - ↓ Collections of sales of fixed and current assets not related to the operation.
- ∉ **Reduction:**
  - ↓ Payments derived from the operation,
  - ↓ Payments by reimbursement of capital,
  - ↓ Payments by reimbursement of long term and short-term debts,
  - ↓ Payments by purchase of fixed and current assets not related to the operation.

It is necessary to consider the different types of transactions which are cited as follows:

1. Transactions between two entries that belong to cash flow.
2. Transactions between one entry that belongs to cash flow and another one that do not.
3. Transactions between two entries that do not belong to cash flow.

The second type transactions are the ones that generate variations in cash flow.

We try to detect the entries that have contributed in the movements of cash flow in order to obtain the CASH FLOW statement. We need to analyze which are the entries that caused the variation of the Current Capital, since cash is a component of the current capital. We will also try to add to the causes previously outlined the derivatives of the entries that are not cash, as well as to transform the investments and financing in payments and collections.

Cash Flow: a complex result from different activities performed by a company

To have a full picture of all cash ins and outs in a company we must consider different parts of or the business. They are the core activities that generate financial movements for a cash flow statement:

1. **Cash flow from OPERATIONS** (with customer, providers, employees and public administration through taxes);
2. **Cash flow from INVESTING activities** which involves spending of cash on fixed assets as additions (to expand business) or replacements (to replace an obsolete asset). We will usually have outflows for a business in this part but we can also have inflows as a result from a sale of a fixed asset;
3. **Cash flow from FINANCING activities** designated for investment in fixed assets (this is the source, where we get cash from). This implies cash inflows for a company.

For the presentation of the cash flow statement there are two methods, direct and indirect. The selection of one or another provides different information in its composition, but the total amount published is the same:

DIRECT method: involves determination of all the collections and payments of the ordinary activity of the company. This information is obtained by adjusting the sales, the sale expenses and other entries of the income statement, for the entries that do not imply cash flow movements or that do not refer to the main activity of the company. This is usually calculated using the beginning and ending balances of various accounts of the company and net result (increase or decrease) in the account.

It is assumed that accounts receivable are used only for credit sales and that sales are managed on credit (no customer pays in advance or immediately on goods or services delivery). Regarding accounts payable, this method implies that they are used for purchases on account and all purchases are on credit.

For example:

Cash receipts from customers =

+ net sales + beginning accounts receivable – ending accounts receivable.

Cash payments to suppliers =

+ purchases + ending inventory – beginning inventory + beginning accounts payable – ending accounts payable.

Cash payments to employees =

+ beginning salaries payable - ending salaries payable + salaries expenses.

Cash Payments for Purchase of Prepaid Assets =

+ ending prepaid rent, prepaid insurance, etc. + expired rent, insurance, etc. – beginning prepaid rent, insurance, etc.

Investment payments=

+ beginning interest payable - ending interest payable + interest expenses.

Income Tax Payments =

+ beginning income tax payable - ending income tax payable + income tax expense.

Reconciliation of all these parts is shown in the following scheme (figure 1):

Operations	Investing activities	Financing activities

Net Increase (Decrease) in Cash

+

The opening cash balance (is last year's closing cash balance)

CLOSING CASH BALANCE

Figure1. Reconciliation of different parts of cash flow statement. Source: own elaboration.

Here is one example of a cash flow statement using a direct method:

	Year 0	Year 1	Year 2	Year 3	Year 4
Cash receipts from customers (global)	5.000	8.250	11.138	14.479	17.375
Cash paid to suppliers (global)	-2.100	-3.500	-5.300	-6.000	-6.500
Cash paid to employees (global)	-1.000	-2.900	-4.100	-4.500	-5.100
Cash flow generated from operations	**1.900**	**1.850**	**1.738**	**3.979**	**5.775**
Investment in equipment (additions)	-15.300	-4.500	0	0	0
Cash flow of investmenting activities	**-15.300**	**-4.500**	**0**	**0**	**0**
Contribution with capital	14.000	0	0	0	0
Dividends	0	0	0	0	-1.000
Loans (external debt)	5.500	0	0	0	0
Issuence of debt (repayment)	0	-1.500	-1.800	-1.900	-1.300
Cash flow from financing activities	**19.500**	**-1.500**	**-1.800**	**-1.900**	**-2.300**
Cash at the beginning of the year	0	6.100	1.950	1.888	3.966
Cash Flow at the end of the year	**6.100**	**1.950**	**1.888**	**3.966**	**7.441**

Usually, when banks decide whether or not to finance a firm/startup they take into consideration the voice "cash flow generated from operations". In fact, only if that figure is positive, it means that the firm produces enough resources to repay the bank debt. In other words, a positive "cash flow generated from operations" indicates debt sustainability.
Banks usually do not take into consideration the voice "cash flow of investing activities" because investments are exceptional expenses that are not made every year, so they do not tell anything about the debt sustainability.

Having a positive relationship with banks is essential if the startup want to survive in the long term. Either because we want to start a business or to consolidate it, financing is an essential element to ensure the growth of our company. Sometimes, in addition, the continuous development of the activity requires specific cash inflows, and even new payment terms with suppliers.

The current situation of an entrepreneur always needs to be known by the lenders and service providers, since they want to be informed about unforeseen payments or changes in forecasts. This way they will trust the entrepreneur or the company more and will be more likely to provide financial support, although frequently more on short than on long term. Thus, it is necessary to have a fluid relationship, to have a climate of trust and seriousness with lenders, creditors, and bankers, as this will facilitate obtaining credit when necessary.

In this regard, take into consideration the following principles:

- Relations with a single really operating bank, the so-called "pivot" on which to focus most of the movements.
- Management according to a strict schedule, so that the time changes in valuation date do not affect the one allocated to the operations of the day, losing a day of interest payable or not obtaining any benefit.
- Banks operating with interest-bearing accounts. This way, if the account has positive balances, you will get some compensation.
- Conciliation and periodic check, usually through a specific "software", of the conditions agreed upon with the banks, claiming errors and the respect for the terms agreed upon.
- Attention to the forecasts of defaults. Not considering the remittances, the bank will charge those defaults that occur on the due date in their due amount, so we must leave a balance that approaches the unpaid % that we foresee. Since we know the defaults up to 10 or 15 days late, we can incur in unintended negative balance.

INDIRECT method: considers that net income shows only earnings and not cash flow, so it cannot represent net cash flow from operating activities. It means that we need to adjust EBIT (earnings before interest and tax) for those items which effect net income regardless whether cash is paid or received against them. In this case we will operate with some new concepts which were not used in the previous method: non-cash expenses such as depreciation, amortization or depletion and non-operating losses and gains on the basis of fixed assets. Remember that depreciation, amortization or depletion imply reduction to the net result of the accounts, but they do not imply disbursement. That is, there will be various adjustments performed to depreciation, amortization, impairment losses and so on. The formula is the following:

***Cash Flows from Operating Activities*:**

	Net Income
+	Non-Cash Expenses (Depreciation, Depletion & Amortization Expense)
+	Non-Operating Losses (Loss on Sale of Non-Current Assets)
-	Non-Operating Gains (Gain on Sale of Non-Current Assets)
+	Decrease in Current Assets (Accounts Receivable, Prepaid Expenses, Inventory etc.)
-	Increase in Current Assets
+	Increase in Current Liabilities (Accounts Payable, Accrued Liabilities, Income Tax Payable etc.)
-	Decrease in Current Liabilities
=	Net Cash Flow from Operating Activities

Expected cash position over a 2 to 3-year timeframe

It is important to underline that higher flows do not necessarily indicate healthier firms per se, on the contrary, we must study how these flows are produced. First, we have to consider the life cycle of the company. Usually when a company grows in terms of sales, it normally also burns cash; whereas when the sales are decreasing the cash it generates is higher than the margin it produces.

Other components:

Harvest and exit – preparing to move to the next venture

A harvest strategy is a marketing and business strategy that involves a reduction or a termination of investments in a product, product line, or line of business so that the entities involved can reap—or, harvest—the maximum profits. A harvest strategy is typically employed towards the end of a product's life cycle, when it is determined that further investment will no longer boost revenues.
https://www.investopedia.com/terms/h/harvest-strategy.asp

As any other business, start-ups should think strategically on what they want to achieve, since capital raising is not about collecting as much as possible but about covering the specific financing needs detected previously through a dedicated analysis. So, they will need a strategic plan that they would present to their potential investors. They will invest if they consider the business attractive and profitable, but then they would be interested in obtaining their initial disbursement and profits (returns on investment). So, it is necessary to speak about the terms here: when, under what conditions, what amount of money, and so on. This is what is called an exit strategy.

Management succession – particularly for family run ventures

Management succession is defined as the plan or process by which new internal leaders are identified and developed to replace existing leaders who will be transitioning out of their current responsibilities due to retirement, disability, termination, or death.

https://www.maximconsulting.com/what-management-succession#:~:text=Management%20succession%20is%20defined%20as,Our%20Approach

When the succession involves members of the same family, we talk about family business succession. While the majority of family business owners would like to see their business transferred to the next generation, according to a survey of KPMG (2011), it is estimated that 70% will not survive into the 2nd generation and 90% will not make it to the 3rd generation.

https://assets.kpmg/content/dam/kpmg/pdf/2015/07/3468-succession.pdf

So, it is necessary to take great care of this crucial business event. In particular, the successful entry of a new generation into the top positions of the family business is not a single event that happens in one day. On the contrary, it should be part of a long-term, well planned process of change. During this period methods and timing of succession must be carefully planned.

https://www.accountancyeurope.eu/wp-content/uploads/1610-Information-paper-SME-Family-business-succession.pdf

The homogeneity of views between the founder and their heirs may be a key element for the successful succession process but it is not enough.

Santiago A. L., Succession experiences in Philippine family businesses, Family Business Review, 2000

First, it is necessary that potential heirs undergo a formation period. A successor cannot be someone without experience. According to Cabrera-Suárez et al. (2001), to plan effective training it is necessary to define:

the minimum requirements for the entry of family members into the business (in terms of age and education), to be used as a reference to verify the quality of external training; internal training programmes adapted to the roles, in consideration of the business needs.
The training is finalized to assume the skills needed to lead the family business.

Cabrera-Suárez, K., De Saá-Pérez, P. and García-Almeida, D. (2001). The succession process from a resource and knowledge-based view of the family firm. Family Business Review, 14(1), 37-47

In addition, it can be requested for the heir to acquire some experience in another company before the official entry into the family business. So that, in addition to acquiring corporate skills, they will also get used to the discipline and to the respect of every role within any organization.

After this training period the potential heir(s) should be evaluated.

According to Handler (1994) the predecessor should involve the Board of Directors in the definition of criteria for the periodic evaluation of the potential heirs, who are to be identified among those who satisfactorily completed the training phase.

Handler, W.C. (1994). Succession in family business: A review of the research. Family Business Review, 7(2), 133-157.

After that, the heir(s) is/are deemed eligible to hold the position by the predecessor and the Board of Directors, the closure of the succession process starts.
According to Chiesa et al. (2007) this phase can be split in two:

1) leadership transfer in which the successor takes the leadership of the family business after a period of top-level collaboration with the predecessor.
2) company reorganization, during which a series of changes to the structure of the family business, mainly concerning aspects of governance and its ownership/organizational structure, in order to allow the new successor to exercise the best of its skills and allow the family business to assume the optimal configuration according to the new distribution of powers to the successor.

http://rivistapiccolaimpresa.uniurb.it/index.php/piccola/article/viewFile/120/128

During the closing phase of the succession process, mechanisms should also be put in place to ensure that the performance of the new successor(s) is monitored in the post succession period.

Exit strategies for investors

Investors will want to know how they will get their money back (and possibly with a positive return) from your business before they invest. Here are summarized the most common exit strategies that startups could present to potential investors in order to attract them.

Initial Public Offer

An IPO consist in a selling of a part (or totally) of your business to the public in the form of shares. Selling the company to the public also means giving the owner the chance to liquidate quickly at least part of their investment. If the company is not listed, instead, the owner needs a long time before finding the right buyer and negotiate the terms of the negotiation. Moreover, even if the company does not want to sell all the shares an IPO can be useful because it allows to increase bargaining power against banks. In fact, access to credit becomes less expensive and easier to obtain after listing on the stock exchange, because a listed company appears more transparent and so more reliable for banks.

However, an IPO is a long and expensive process involving several actors. The first task of the company's managers is the selection of underwriters. The latter are generally high standing banks that follow the company from its inception of the IPO until the actual listing on the stock exchange, becoming the first owner of the shares, which they then resell to the public, and thus taking the risk that they will not be actually sold on the market.
The costs of an IPO generally arise from the advisory fees in favour of underwriters.

Merger & Acquisition (M&A).

This normally means merging with a comparable company (merger) or being bought by a larger company (acquisition). In particular, when one company takes over another entity, and establishes itself as the new owner, the purchase is called an acquisition. From a legal point of view, the target company ceases to exist, the buyer absorbs the business, and the buyer's stock continues to be traded, while the target company’s stock is not. On the other hand, a merger describes two firms of approximately the same size, who join forces to move forward as a single new entity, rather than remaining separately owned and operated. This action is known as a "merger of equals." Both companies' stocks are surrendered, and new company stock is issued in its place.

https://www.investopedia.com/terms/m/mergersandacquisitions.asp

Private Offerings

Start-ups can conduct a private offering of shares to individuals or a select group of investors to raise funds. Private offerings are less expensive since the services of underwriters or brokers are less required. You can choose investors who exhibit similar goals and interests, offering these investors more complex and confidential transactions. If these investors are entrepreneurs themselves, they can help in the company’s management.

https://www.huffpost.com/entry/six-startup-exit-strategies_b_8254780?guccounter=1&guce_referrer=aHR0cHM6Ly93d3cuZ29vZ2xlLmNvbS8&guce_referrer_sig=AQAAAI1R6-fm307yM4kQli1Q38SfbriFtZXVa4uFA69iGfL0YHUzSUZut-PKOAP1ZwCjcss43uCAXhwQu3T5H8kHcW37pceOvzmsrZJ2I-VzY5JlLrEFqKdaMS8CNS3DKE5yNVYIEIm8fnomPWH1PVX64Vwyzr3q24Prf31FDWJ4STMr

However, the owner usually needs a long time before finding a reliable buyer and negotiate the terms of the negotiation.

Cash Cow

Cash cows are firms that are able to command a high market share in an industry dominated by low growth. They are able to sustain enough capital to stay afloat for the foreseeable future as they promise years of increased profits. So, If the firm is in a stable, secure marketplace, operates a business that has a steady revenue stream, can pay off investors, the owner can find someone reliable to run the company, while the group leader can use the remaining cash to develop new ideas. So, they can retain ownership and enjoy the annuity.

https://www.entrepreneur.com/article/217842

Liquidating

Liquidating as an exit strategy is where the company sells all of its assets – typically at a lower cost than market price. Not to be seen as a bad option, this is a recommended strategy when the firm enters in decline phase. If the firm choose this route, has to know that it will need to use cash to pay off shareholders if there are any as well as eliminate any debts.

https://about.crunchbase.com/blog/what-is-an-exit-strategy-and-why-do-you-need-one/

➢ Fundraising

When an entrepreneur wants to start a business and launch a new product or service always needs funds. Therefore, it is crucial to understand the different sources of finance and to assess access to them in terms of availability and cost.
It is possible to combine these different options, choosing the right mix at a right time. This is a key challenge for every entrepreneur and their finance managers to make the company sustainable.

Financial sources can be distinguished between traditional finance and alternative finance.

Traditional Finance

The most common sources of financing used by entrepreneur and startups are equity and bank loans.

Equity

Equity (share capital) is an internal financing source. A company is owned by its shareholders who personally contribute to the company's capital called equity. They assume the highest risk in a business, but they also may have profits out of this capital, and sometimes rather high. Besides this initial capital, equity also includes retained earnings. This is what is called self-financing, that is, a company retains partially or totally profits to finance its projects. Equity represents the common stockholders' interest in the corporation. It also sates for certain guarantee for a business. That means that, with a significant amount of share capital invested to take primary risk of the business, a bank will be more willing to provide loans to the company.

Bank loans.

Loan is an external financing source, either on a short (up to 12 months) or on a long term (more than 12 months). Money lent by banks or creditors from financial markets that must be returned within an agreed period together with interests and certain costs per operation and according to certain repayment system.

These sources of capital are included in a balance sheet. A good balance between these sources in a company is a dependence on equity in 40% - 60%. Although, this ratio should be analysed according to the industry in which a company operates and some other factors.

Working capital.

It is the amount of current assets in the firm that are not financed by current liabilities. It is a measure of a company's short-term financial fitness as well as its efficiency. Positive working capital shows that a firm can pay off its short-term liabilities, which is important for a financial balance of a firm. But bear in mind that it is possible to have a positive working capital and still be unable to handle a large, unexpected cash need. Negative working capital shows that a firm is currently unable to offset its short-term liabilities with its current assets. This is a synonym of financial difficulties; bankruptcy is the most severe.

Working capital must be enough to keep the stock level of raw material, of products under production and of finished products to attend the demand. Besides that, it provides appropriate credit-time to the customers according to the established collection period.

Overdrafts.

This type of financing is not recommended; it is virtually impossible for new companies or entrepreneur to get it for the lack of experience the bank has with them. It is about the bank being able to cope with the payments made by a company, regardless of not having available the necessary funds in the account. This is just a loan that is granted to the company, depending on its solvency and rigor (an unknown factor for new companies or for entrepreneurs), in relation with the non-compliance of its obligations. It means not having a debt balance in the bank account, what is commonly called 'to be in the red'. The main disadvantages of this financing source are, among others, its really high costs regarding the interests of the overdraft and its limited amounts.

Security and collateral requirements, margin on interest base rate.

Debt allows the company's owners to maintain their ownership, so, this is an advantage, and the disadvantage is that it must be paid back in regular terms. Besides that, the interest of the credit and the credit availability are associated to the risk the company presents and collaterals it can provide. So, the more collaterals (fixed tangible assets) the company has, the more available the debt is. And the higher the risk (high level of information asymmetry and uncertainty about future performance), the more expensive (more return is demanded) or the more rationed the debt is. So, according to Cole and Sokolok (2017), better-quality start-up companies have more possibilities to obtain debt through banks. The authors also add that debt is directly related to survival rate of start-up companies: "most firms that used debt in their initial capital structure survived their first three years of operations. If they survive, they also have significantly higher revenues three years after the firm's formation".

Nevertheless, debt looks like less attractive for start-ups or small businesses than equity, since the advantage offered by equity is the provision of funds for innovative activities, typically research and development (R&D). They usually are hard to finance through banks due to the uncertain nature of the results (either the credit is rationed or unavailable or the interests are too high, because this is a sort of compensation to the bank for assuming high risks of the operation). So, the own capital suits best these particular needs. But remember, equity is limited, so, prioritize all the needs and plan.

Cash flow for loan repayments

Take care of your relationship with banks either because we want to start a business or to consolidate it, financing is an essential element to ensure the growth of our company. Sometimes, in addition, the continuous development of the activity requires specific cash inflows, and even new payment terms with suppliers.

The current situation of an entrepreneur always needs to be known by the lenders and service providers, since they want to be informed about unforeseen payments or changes in forecasts. This way they will trust the entrepreneur or the company more and will be more likely to provide financial support, although frequently more on short than on long term. Thus, it is necessary to have a fluid relationship, to have a climate of trust and seriousness with lenders, creditors and bankers, as this will facilitate obtaining credit when necessary. In this regard, take into consideration the following principles:

- Relations with a single really operating bank, the so-called "pivot" on which to focus most of the movements.
- Management according to a strict schedule, so that the time changes in valuation date do not affect the one allocated to the operations of the day, losing a day of interest payable or not obtaining any benefit.
- Banks operating with interest-bearing accounts. This way, if the account has positive balances, you will get some compensation.
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- Attention to the forecasts of defaults. Not considering the remittances, the bank will charge those defaults that occur on the due date in their due amount, so we must leave a balance that approaches the unpaid % that we foresee. Since we know the defaults up to 10 or 15 days late, we can incur in unintended negative balance.

Alternative finance.

Usually lack of internal cash flows and guarantees cause difficulties for SMEs and start-ups in raising financing from banks. Especially in the early stages start-ups and SMEs usually have modest cash flows and do not possess intangible or tangible assets that can be used as collateral for loans. However, there are many alternative forms of financing that start-ups and fast-growing SMEs in innovative sectors can use depending on the phase of their life cycle. The financial literature classifies different phases of firm's life cycle: seed, start-up, development, expansion, and maturity.
While in the initial seed phase the company begins to evaluate market opportunities and search for resources that can complement its skills, in the subsequent start-up phase the company proves to be more executive and is more inclined to planning. In the following phases, with the progressive expansion of the company's activity, the resources sought are proportional to the need for expansion.

Every phase usually involves different kind of investors. In particular, the initial seed phase involves business angels, accelerators, and incubators, while the subsequent start-up and initial development phases generally venture capitalists, crowdfunding and family offices. Finally, in the subsequent phases of the business life cycle, which include expansion and maturity, private equity operators intervene.

Accelerators and incubators

Accelerators and incubators are structures that invest a small amount of money in a large number of start-ups and offer them assistance services, experience and specialized know-how, business contacts and office space, with the aim of helping start-ups define their products and identify their customers.
Although accelerators and business incubators are similar, some slight differences exist: the duration of the programs of business accelerators is usually three months, while in business incubators the duration of the programs ranges from one year to five years.

Business angel

The business angel, or angel investor, acts and assists the start-up in the phase of product testing or business creation. Often, in this phase, the investment takes place without the target company having drawn up a business plan, so that investing requires high technical and managerial skills are required. The business angel is usually someone personally enthusiastic about a start-up, so that they finance it and help it investing capital, and through their experience, knowledge, contacts. Unlike investment funds, the business angel invests their own resources, and their motivation is not exclusively financial.
Several business angels together can create a group financing (syndacation) to distribute the risk, each investing a small part of money, but overall reaching high figures. Business angels mainly have long-term investment horizons, with investment holding periods of 5 or more years.

Crowdfunding

There are online platforms, called crowdfunding platforms, through which many investors (professionals and non-professionals) can finance ideas, projects and new start-ups through contributions of different nature and amount.
This new form of financial intermediation makes it easier for start-ups seeking funding to reach a large number of potential investors, who in return receive a physical or moral reward in proportion to the funds invested.
We can find four different forms of crowdfunding, classified according to the nature of the reward paid to investors:

- reward-based crowdfunding: lenders receive a reward that can never be in cash, it usually consists of a product or service related to the company's business, but can also be a simple written thank you to the lender.
- donation-based crowdfunding: lenders do not receive a material reward, but a moral one and can benefit from an improvement in their social image.
- lending-based crowdfunding: lenders are remunerated with fixed interest rates for their loans.
- Equity-based Crowdfunding: investors could become shareholders in the financed company through the purchase of a small shareholding (equity). In return for their contribution, investors will share in the potential profits of the company.

Venture capital

Venture capitalists mostly intervene in the start-up financing phase.
Unlike the seed phase, in this type of intervention the product has already been designed and tested, but the company needs capital for its growth, so there is less need of technical-scientific skills for the investor. However, in general, this phase requires more capital to invest than the seed phase. Beyond the return of investment, the venture capitalists receive decision-making power and thus participate in the start-up. Their investments involve the assumption of very high risks, due to the great uncertainty about the future performance of the companies. The target companies have specific characteristics in terms of structure and development and are characterized by innovation and strong growth prospects.

Family offices

Family offices are service companies that manage the investments of wealthy families. Their activities include both tax and financial planning and advisory services, as well as investment asset allocation and related administration services.

The volume and sectoral distribution of investments in family offices is largely unknown due to lack of data. While they are particularly developed in the sophisticated American market, it is estimated that the number of European family offices exceeds 700. These are concentrated in Switzerland, the UK and Germany, while they are practically absent in Eastern Europe. With a few exceptions, most family offices do not have a website and cannot be found through network organizations.

Private *equity*

Private equity concerns investments in mature companies. The private investor assists the firm in those operations involving replacement, restructuring of the company in a crisis phase or accompanying the public listing. More specifically, four types of intervention can be distinguished in the world of private equity:
- Expansion financing,
- Replacement financing,
- Buy-out financing,
- Turnaround financing.

With expansion financing, the development phase of a company that aspires to listing through an initial public offering (IPO) is financed.

In replacement financing, a stake in the company is purchased, replacing the previous company structure, in order to find new investors to resell the stake and achieve a capital gain.

The buy-out financing is an intervention linked to a leveraged buy-out (LBO), whose promoters are a group of managers, often from the target company. The procedure consists in the creation of a New Company (NewCo), in which the financial resources of the private equity investor that supports the promoters of the operation are channelled. Subsequently, the NewCo is merged by incorporation with the target company or its assets are transferred to the target company, receiving shares in the latter in exchange. The LBO transaction makes significant use of leverage and is therefore considered more risky than a Mergers and Acquisitions (M&A) transaction.

Turnaround financing is an investor intervention aimed at a restructuring plan of companies that suffer from a financial breakdown.

These four private equity transactions have in common the aim, which is to achieve capital gain from the transactions in the shortest possible time, so that capital can be reinvested in new transactions. Therefore, private equity transactions differ from venture capital transactions in that the single transaction is associated with a lower gain, but with the intention of making as many transactions as possible by reinvesting the gains several times.

Exploiting blockchain in fundraising: Initial Coin Offering (ICO)

ICOs, Initial Coin Offering, represent an innovative form of financing for start-ups that want carry out a project based on blockchain.
In essence, instead of requesting funds from the banking system for new investments, companies propose to the public through the web a specific business project, called “with paper”, in which they explain their business plan, objectives and context.

At this point, the start-up offer tokens to the public in pre-sale, each of which will allow to "withdraw", through the execution of a download, a future service of an app still in planning.
In order to issue tokens and be able to place them and negotiate on the blockchain they are "hooked" to a cryptocurrency and are placed at a price lower than the price set for a normal sale.
After the ICO, tokens are exchanged on special platforms where proposals for purchase and sale

take place. The financial return of the first investors is therefore linked both to the eventual success of the project for which they were issued and to the volatility of the cryptocurrency to which the token is attached.

European Union funding sources – required stringent use of funds and benefit to the community

EIC Accelerator[1]

The EIC Accelerator (previously SME Instrument) is part of the European Innovation Council (EIC) pilot that supports top class innovators, entrepreneurs and small companies with funding opportunities and acceleration services. The main focus of the EIC Accelerator is on market-creating innovations that shape new markets and generate jobs, growth and higher standards of living. EIC created an environment of support for SMEs that includes funding, business accelerator services and a community of practice

Funding

The EIC Accelerator supports **high-risk, high-potential small and medium-sized enterprises** and innovators to help them develop and bring onto the market new innovative products, services and business models that could drive economic growth. Selected companies receive **funding and optional equity** and are offered business coaching and mentoring to scale up their innovation idea. They get extra acceleration services to connect with investors, corporates, and likeminded entrepreneurs. As an EIC Accelerator client, you will gain visibility and boost your chances of success in European and international markets.

The EIC Accelerator is designed for small and medium-sized enterprises (SMES) with radically new ideas underpinned by a business plan for rolling out marketable innovation solutions and with ambitions to scale up. It targets for-profit SMEs only, including young companies and start-ups, from any sector - there are no set topics. From 5 June 2019 only single companies (as opposed to consortia) can apply for EIC Accelerator. Companies that apply must be established in an EU Member State or a Horizon 2020 associated country. Large corporates, research centres or scientists cannot apply directly but they can participate in projects as subcontractors or third parties and don't need to be established in an EU Member State or associated country.

The EIC provides support to the full business innovation cycle. For early-stage research and innovation, projects can seek support from EIC Pathfinder pilot. SME Instrument phase 1 has been phased-out and this funding is no longer available.

EIC Accelerator helps you develop your business concept further into a market-ready product, service or process aligned with your company's growth strategy. Activities could, for example, include trials, prototyping, validation, demonstration and testing in real-world conditions, and market replication. If the activity concerns a primarily technological innovation, a Technology Readiness Level (TRL) of 6-8 is envisaged for projects requesting grants only. Projects will receive between € 0.5 and € 2.5 million in the form of grants. They can request a higher or lower amount when applying but it needs to be duly justified. Projects should normally take 12 to 24 months to complete but could be longer in exceptional and well-justified cases.

From 5 June 2019 the EIC Accelerator offers **blended finance** in the form of an optional investment in equity in addition to the grant, to single for-profit SMEs. Grants will finance activities from TRL 6-8. Applicants will be asked to indicate if they want blended finance and the amount requested for equity. The maximum of investment in the form of equity is € 15 million.

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[1]https://ec.europa.eu/easme/sites/easme-site/files/eic_accelerator_fund_pilot_investment_guidelines_for_applicants_0.pdf

Running projects can under certain circumstances request additional blended finance potentially combined with a top-up of their grant.

Starting on 18 March until 19 May 2020, applicants will be able to apply for the Green Deal topic specifically concentrating on those innovations that fuel the societal transition towards sustainability while supporting EU's competitiveness and leadership in clean technologies. The topic targets high-risk, high-potential small- and medium-sized enterprises (including start-ups) from any sector provided that they contribute to one or more of the **Green Deal goals** as mentioned in the draft work programme.

Business acceleration services and coaching

The EIC pilot offers free coaching, business acceleration services and mentoring to help your business scale up and grow. These are open to all small businesses that are EIC clients, simultaneously to their grant. Coaching covers business development, organisational development, cooperation, and financing. SMEs taking part in EIC Accelerator, FTI or Pathfinder are offered up to 12 coaching-days. The free-of-charge coaching service is facilitated by the Enterprise Europe Network (EEN). Other business acceleration services are offered in the form of partnering and networking with investors, larger firms and other SME clients. These happen through specific events and through the online EIC Community.

Applicants will first have to submit a paper-based proposal of their project that will be evaluated remotely by four independent experts. A selected number of proposals will be invited to Brussels to pitch in front of a Jury. For more information have a look at how proposals are evaluated. To apply you are invited to register and submit your proposal on the Horizon 2020 Funding &Tenders Portal. Before applying we invite you to read the full details about submissions, eligibility and admissibility criteria and the evaluation procedure in the Guidelines for Applicants and the 2018-2020 Work Programme on the Horizon 2020 Funding and Tenders Portal. We also advise you to get in touch with your Enterprise Europe Network regional office and have a look at our tips for applicants.

The EIC Accelerator is a continuously open call with regular cut-offs. Below are the cut-off dates for 2018-2020. These dates are indicative and may change.

Phases	**2018**	**2019**	**2020**
Phase 1	08 February 2018 03 May 2018 05 September 2018 07 November 2018	13 February 2019 07 May 2019 05 September 2019 - final deadline	
Phase 2 EIC Accelerator	10 January 2018 14 March 2018 23 May 2018 10 October 2018	09 January 2019 03 April 2019 05 June 2019	08 January 2020 - grant only or blended finance 18 March 2020 - grant only or blended finance

		09 October 2019 - grant only or blended finance	19 May 2020 - grant only or blended finance **GREEN DEAL topic only*** 07 October 2020 - grant only or blended finance

Apply here