

## ENTREPRENEURSHIP AND DESIGN THINKING

### LECTURE 9: FINANCIAL REQUIREMENTS FOR ENTREPRENEURS

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#### Overview

- In our last lecture, we looked at marketing requirements for entrepreneurship, where we looked at;
  - How entrepreneurs can better understand their markets
  - Create a unique value proposition
  - Adopt some digital marketing essentials
- In the current lecture we will look at the financial requirements for an entrepreneur; specifically, we will focus on;
  - Understanding the startup costs
  - Sources of funding
  - Financial management skills
  - Investment strategies



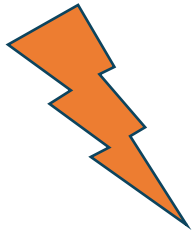
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## Learning Outcomes

- Understand the different cost the initial and ongoing expenses for a startup
- Evaluating different sources of funding available to an entrepreneur
- Examine critical financial management skills an entrepreneur needs to succeed
- Propose possible investment strategies an entrepreneur can pursue

## Introduction

- Whenever we talk of financial requirements for an entrepreneur, we are talking about the money that one needs to start, operate, and grow their venture
- Having such money, and in the right time is crucial for an entrepreneur, for it can mean success or failure for their venture.
- Even at personal level, financial management is crucial to successful go through life
- We will start off with understanding different cost in running a venture



### **Question**

If you are to start a venture, what costs are you likely to incur? - list them down.

## Understanding Startup Costs

- When you are starting a business there are different costs that you are likely to incur.
- In your BMC lecture we touched on this though lightly
- We have two major categories of cost we can talk about; Initial costs and Ongoing costs

## Initial Costs

- These are all the expenses that you are likely to incur once before launching the business (How to Finance a Business: 4 Options | HBS Online, 2020)
- The costs are likely to be in line of:
- **Product development:** the cost that goes to bringing a product to market
- **Market research:** The initial research, survey you need to do before settling on a customer segment and a location

- **Legal and licensing fee:** Permits needed to operate a business such as health permits for a restaurant
- **Technology and equipment:** Computers, printers, phones, and furniture among others
- **Intellectual property acquisition/protection:** Where your venture is dependent on IP, its protection or acquisition need money.
- They may be high, but an entrepreneur should apply financial management strategies such as budgeting, research, negotiation and planning to try and reduce or spread them

### Ongoing Costs

- These are on-going expenses for the business that helps in day-to-day operation of the venture
- They may include:
  - **Rent and utilities:** the monthly expenses for the office or shop for your business and bills such as power, internet, water that you pay.
  - **Salaries and wages:** The payment that you make regularly compensating your permanent and casual employees
  - **Inventory and supplies:** The cost you incur purchasing good for both re-sale as well as for use in your office such as stationary
  - **Marketing and sales expenses:** This represents the cost of keeping your customers informed and engaged as well as pushing your product or service such as promotions advertising.
- Equally, in this category an entrepreneur must be prudent and efficient in use of resources.

### Funding Options for Startups

- If you ask most entrepreneurs, they will say finance/capital is the biggest challenge they have to overcome
- *If you were to start a business, where would you go for capital and why?*
- *What do you think are the common mistakes entrepreneurs make in sourcing for funds?*
- The sources of funding for a startup can be categorized as follows:

#### 1. Bootstrapping:

- Often called self-funding and include
- Use of your savings

- Retirement funds
- This source gives you full ownership of the business

## **2. Friends and Family**

- You can seek support from your close family and friends
- It may take direction of a grant or a loan
- If a loan they may attract low interest rates
- Often without too much legality and conditions

## **3. Crowdfunding**

- There are platforms that an entrepreneur can use to pitch their business idea
- The platforms allow the entrepreneur to collect small amounts from many people
- Examples of such platforms include GoFundMe, Kickstarter, SeedInvest, Crowdcube, and Indiegogo.
- They may take different form and shape such as debt-financing, donation, equity, or reward-based financing
- If many people are interested in your idea, it also acts as a validation of your idea
- Give you a wide access to investors
- It helps you in creating exposure
- It also helps you to build an engaged community who are emotionally invested in your business success
- On the flip side, they are very competitive

## **4. Debt Financing**

- This is normally in a loan form, it is to be paid back
- You can approach financial institutions for a small loan
- The institutions could include banks, credit unions, microfinance institutions, saving and credit cooperatives (common in Africa)
- Trade credit is also an option here where you can buy goods on credit and pay later usually within 30-90 days
- The benefit of this as a source of fund is that you maintain ownership
- They have predictable payment schedules
- However, the cost may be high-interest rate
- Some require collateral
- When going for this, compare different lenders and read the fine prints

## 5. Equity Financing

- In this category, the entrepreneur raise money by selling ownership state in their venture
- Capital is raised in exchange of ownership in the business
- There are different options in this category such as;
- Angel investors: High net worth investors who invest their money in startups or early-stage companies. Examples of angel investors the shark tank investors
- Venture Capital: These are firms who pool funds from individuals, corporations and business to invest in startups.
- Initial Public Offer (IPO): This is when a private company decide to raise capital by offering its shares to the public through security exchange
- Equity financing is good as there is no need to pay back the debt
- There is also shared risk between the entrepreneur and investor
- There is value addition from the investor who in most cases are professionals
- On the flip side is that there is profit sharing, loss of control and ownership



### Essential Financial Management Skills for an Entrepreneur

- For your venture to succeed and be sustainable you need financial management skill as an entrepreneur
- The skills are to help you make informed decisions, allocate resources prudently, and drive growth in your business
- Here are some key skills you must develop:
  - **Budgeting and Financial Planning:** Creating a realistic budget that captures expected income, expenses, and saving
  - **Financial forecasting:** Ability to predict future revenue, expenses and cashflow based on market trends is important
  - **Cashflow:** A clear understanding of how money flows in and out of your business is important to avoid liquidity issues as an entrepreneur
  - **Cost management:** Understanding aspects such as fixed versus variable cost and regular review of your cost with view of reducing unnecessary cost is critical skill

- **Pricing strategies:** Though in marketing, this skill is needed. Determining the right pricing strategy is important in covering costs and generating profits for the business
- **Debt management:** This entails proper and responsible use of credit by the business and striking the balance between debt and equity financing
- **Tax planning:** Every business is expected to comply with its tax obligations, an entrepreneur must be conversant with such and be able to file for the same.
- **Negotiation skill:** Often than not as an entrepreneur you will be representing your business in so many different forums, where you will be required to strike deals such as credit or with suppliers. How good you are in negotiation will determine the value you get in those negotiations.
- **Risk Management:** In as much as we noted that an entrepreneur needs to be a risk taker, you must be able to identify possible risks and come up with mitigation strategies
- **Funding raising skill:** You must also develop pitching skill to be able to convince investors to invest in you or generally to raise funds whenever your business needs such
- **Financial Discipline:** Often most entrepreneurs fail because they lack financial discipline. Adhering to the budget and being able to separate business money from personal money is something most entrepreneurs must learn.

### **Investment Strategies**

- Part of using your resources well as an entrepreneur is decision pertaining to investment. The investment decisions will revolve around the following:
- **Reinvestment:** Purpose to plough back the profit to the business, this will help your business to grow organically without debts
- **Diversification:** This means spreading your capital investment in different asset lines or product ranges. It is a way to grow as well as minimizing your risks
- **Long-term Investment:** When an entrepreneur wants to build wealth so as to secure finances for future growth, they may invest in tools such as stocks and bonds.
- **Short-term investment:** When an entrepreneur has excess cash, they can invest such in short-term investment vehicles such as money markets, treasury bills or fixed deposits with banks

## Scenario

Sarah is an aspiring entrepreneur who wants to open a small café in her neighborhood. She has saved some money and is considering various funding options to cover her initial expenses. Sarah needs to understand the financial requirements to ensure her business is successful.

## Engagement questions

- What would her initial expenses be?
- What funding options should Sarah consider and why?
- What key financial management skills should she focus on?
- Identify possible financial risk Sarah might face and propose strategies to mitigate these risks

## Topic Review

- The topic focused on financial requirements for an entrepreneur
- Different costs incurred when starting and running a startup
- Different sources of funding
- Essential financial management skills an entrepreneur must learn
- Investment strategies an entrepreneur need to think about
- The next lecture we will talk about choosing the right location and layout

## Reference

*How to Finance a business: 4 options* / HBS Online. (2020, August 4). Business Insights Blog.

<https://online.hbs.edu/blog/post/how-to-finance-a-business>

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