Financing a new business – indoor bike park

GRADES 11/12

In this lesson, students will learn about the different financial options entrepreneurs use to raise money for a business.

Subject

BDI3C – Entrepreneurship: The Venture
BDP3O – Entrepreneurship: The Enterprising Person
BDV4C – Entrepreneurship: Venture Planning in an Electronic Age
BAT4M – Financial Accounting Principles

Suggested timing

70 minutes

Financial literacy objectives

At the end of this lesson, students will:

- use financial terminology fluently;
- use data to make financial decisions;
- identify methods of obtaining capital for financing a business;
- analyze pros and cons of investing in a business venture.

Curriculum expectations

Business Studies, Grades 11 and 12 (2006)
Entrepreneurship: The Venture (BDI3C)

The Financial Plan

- identify sources and methods of financing their chosen venture (e.g., government loans, private investors, bank loans, loans from family and friends, credit from suppliers).

Entrepreneurship: The Enterprising Person (BDP3O)

Entrepreneurial Characteristics and Factors Affecting Successful Entrepreneurship

- identify the attitudes, attributes, and skills common to many entrepreneurs;
- identify some Canadian and local entrepreneurs and describe their achievements;
- describe the barriers that various entrepreneurs (e.g., women, people with disabilities, Aboriginal peoples, new immigrants, people from various ethnocultural minorities) have faced in the past and the factors that are contributing to their success today (e.g., funding, education, changing attitudes, mentoring);

- describe the roles of entrepreneurs that benefit communities and society (e.g., agents of change, creators of jobs and wealth, role models of ethical behaviour, advocates for community development).

Entrepreneurship: Venture Planning in an Electronic Age (BDV4C)

Financing

- estimate the amount of capital that would be required to launch their venture;
- identify the advantages and disadvantages of various sources of capital for their venture (e.g., family, personal savings, bank loan, private equity, government grants);
- develop an effective strategy for raising capital for their venture.

Financial Accounting Principles (BAT4M)

Financial Accounting

- compare the advantages and disadvantages of debt financing and equity financing;
- describe alternative sources of funding available to businesses (e.g., venture capital, government loans and grants).

Assessment

Collect worksheets, posters and/or crossword.

What you need

- Financing options (Appendix A)
- Financing options chart (Appendix B)
- Financing characteristics – cut into strips (Appendix C)
- Financing options pros and cons worksheet (Appendix D)
- Crossword puzzle (Appendix E)
- Financing options chart (solutions, Appendix F)
- Financing options pros and cons worksheet (solutions, Appendix G)
- Crossword puzzle (solutions, Appendix H)
- Bag or hat to be used for a draw
- Poster boards

Context for learning
Bill Fold is a character who is constantly getting himself into financial scrapes. Use the scenario below to provide students with a context for learning.

Bill Fold and his buddies love to ride their BMX bikes throughout the year. However, during the winter months, they find it hard to do tricks outside in the snow. Bill has a brilliant idea for a business venture. He could rent the old warehouse near his house and build ramps for an indoor bike park. He could make a profit if he charged a fee for the use of the park. Bill would need financing to get this brilliant idea of his going. But where and how will he get the capital to get this project off the ground?

From what you know of various financing options, what kind of financing would you recommend he pursue?

Minds on

Ask students to think of some Canadian entrepreneurs who have started successful companies. Ask a volunteer(s) to write on the board the names of the entrepreneur and the company.

In a trivia-style format, ask students if they could identify the following:

- entrepreneur's business or industry;
- how he/she might have raised money to get started;
- impact of business (e.g., economic, societal, cultural, etc.).

Teacher: Examples of entrepreneur, business and financing method:

Entrepreneur	Business/industry	Financing method
Mike Lazaridis	Research in Motion/ Technology	Savings, family investors
J. William Billes and Alfred Billes	Canadian Tire/Retail	Savings
Dean and Dan Caten	Designers - DSquared2/ Fashion	Financial backer
John Molson	Molson Breweries/ Beer, Wine and Spirits	Family funds
Ed Mirvish	Honest Ed's – Mirvish Productions/ Retail or Entertainment	Fund from life insurance policy
Chris Haney and Scott Abbott	Trivial Pursuit/inventors	Sold shares

Action

Explain that there are different methods to raise capital: (i) equity and (ii) debt financing. Distribute copies of Appendix A and review the difference between debt financing and equity financing and give examples.

Think-Pair-Share

Students turn to the person beside them and explain in their own words the term "equity" and "debt" to their partner. Ask the partners to differentiate between the two forms of funding by sharing examples.

Activity

- Distribute financing options chart (Appendix B)
- Divide students in 4 groups and assign each group a financing option (i.e., government grant, friends and family, venture capital, bank loan).
- Each group decides if their option represents debt or equity financing.
- Put the strips of paper containing the financing characteristics in a bag and have students draw a slip from the bag until all the strips have been distributed.
- Taking turns, students read their financing characteristic aloud to the class and identify the financing method to which it could apply. As a class, discuss answers to come to an agreement.
- Students will individually complete Appendix B by checking off all applicable financing issues related to their various financing options.

Action (cont'd)

- In their groups, students discuss how an entrepreneur would estimate the amount of funds required to launch his/her business and what documents might be required when seeking financing.
- Students then prepare posters marketing their type of financing. Students should include the pros and cons of acquiring capital through their particular method of financing.
- Mount completed posters on classroom walls.

Consolidation/ debrief

Distribute a copy of Appendix C and/or the crossword (Appendix E) to all students.

Students circulate around the classroom completing their worksheets by looking at the various posters.

Discuss with students the following questions:

1. Explain the difference between debt and equity financing.
2. Which would you prefer to receive as an entrepreneur and why?
3. If you were a lender providing financing, would you rather provide debt or equity financing? Why?
4. If you were asked to invest in a new venture, what non-financial factors might you consider before investing in a new business?

What are the different financing methods available?

Debt financing	Equity financing
• Provided by a creditor (must be repaid at some pre-determined date) • Can be difficult to repay • Interest must be repaid as well as the principal • Debt covenants (restrictions placed on financing) can occur • If the borrower (entrepreneur) does not adhere to restrictions, loan can be recalled, terminated or forcibly repaid immediately	• Using savings to inject new equity into the business • Primarily done through personal and/or family savings • Can be done by an outside investor, purchasing equity (ownership interest) in the company

Debt financing in more detail

Personal

Money that comes from your savings, sale of assets, credit cards, leveraging assets, etc.

Credit cards:

- Instant access to cash.
- There are high penalties for failing to pay money back on time.
  High annual fees, high interest rates (>20%), annual fees and late charges are all potential problems.

Leveraging a home:

- Home equity loan means taking a second mortgage from a bank, using your home as collateral.
- The entrepreneur must make additional payments on top of first mortgage.
- Failing to make these payments, the bank takes the home.
- Interest rates for these kinds of loans are high.

Friends and family

This type of financing can be obtained quickly as it is based more on personal relationships than on financial analysis.

- Friends and family who provide loans sometimes feel they have the right to offer suggestions concerning the management of the business.
- Tough business times may strain the bonds of friendship and family relationships.
- Repayment terms are usually more generous than other options (i.e., banks).
- Interest may/may not be charged.

What are the different financing methods available? (cont'd)

Chartered banks and credit unions
These financial institutions are primarily lenders of debt capital to small businesses.

Can take out a term loan/mortgage: interest and principal must be prepaid.
Can take out a line of credit: lender provides credit up to a stated amount, which is backed by the company's inventory and receivables.

Government sponsored programs and agencies
There are a few government programs that provide financing to small businesses. Although funds may be available, they may be difficult to acquire.

Canada Small Business Financing program: provides financing to small businesses through financial institutions, for which the federal government guarantees repayment.

Loans

- Loans can be used to finance buildings and land, commercial vehicles, equipment and software, and leasehold improvements.
- Loans cannot be used to finance working capital, inventory, franchise fees, research and development.
- The cost of the loan is determined by the financial institution and can have a fixed or variable rate of interest.
- In addition, there is a registration fee which must be paid by the borrower to the lender. The registration fee and a portion of the interest are submitted to Industry Canada to help offset the costs of the program for the government.

Government also offers many similar programs whose primary focus is not on financing but rather on small business development, including: Business Development Bank, Industrial Research Assistance program, Global Commerce Support program and tax incentives and write-offs.

What are the different financing methods available? (cont'd)

How does a lender decide if a small business is deserving of a loan? Consider the **5 Cs of credit:**

1. **C**haracter of the borrower
   - Is the borrower trustworthy; will the borrower use the money responsibly, and work hard to ensure the business venture succeeds; does the borrower have any expertise/knowledge?

2. **C**apacity to repay the loan
   - Will the borrower be able to repay the loan according to the terms of the agreement?

3. **C**apital being invested in the venture by the borrower
   - Has the borrower invested any of his/her own funds in the venture?

4. **C**onditions of the industry and economy
   - What is the current and forecasted economic landscape for the business/industry?

5. **C**ollateral available to secure the loan
   - Does the borrower have collateral to secure against the loan in the event that the venture fails?

Equity financing in more detail

Venture capital firms

- Venture capitalist: an investor or investment group that commits money to new business ventures.
- Usually the venture capitalist provides financing to a new business, but the investment takes the form of convertible debt or convertible preferred stock. This way, they have senior claim over the assets should the business fail, or they can convert stock to actively participate in the business if it is successful.
- Venture capitalists typically provide a large source of financing to a business.
- It is not a loan, therefore, it is does not need to be prepaid and no interest is charged.
- The entrepreneur is selling part of his/her business to someone else. Is the business person comfortable with this? What percentage of his/her company is he/she willing to part with? Is he/she willing to give up control (> 50%) to someone else? Is he/she willing to share profits?

Stock sales

- Selling shares of the company to outside investors.
- Usually very difficult to do, especially for companies that are new with no track record as investors are usually reluctant to purchase shares.
- Like venture capitalist, this is not a loan, so there are no interest charges, but the owner must give up a percentage of the company.

Financing options chart

	Debt capital	Equity capital	Personal savings and credit cards	Friends and relatives	Banks	Government assistance programs	Venture capitalists	Selling shares
Additional interest								
Annual fees								
Collateral								
Covenants								
Difficult to acquire								
Easy to acquire								
High interest								
High penalties								
Late charges								
Leveraging								
Loan								
Losing portion of company								
Strain interpersonal bonds								
No repayment								
Offer suggestions re: management of business								
Repayment: interest								
Repayment: principal								
Canada small business financing								
Stock and shares								

Financing options characteristics

Print terms, cut into strips and draw from hat.

Additional interest
Annual fees
Collateral
Covenants
Difficult to acquire
Easy to acquire
High interest
High penalties
Late charges
Leveraging
Loan
Losing portion of company
Strain interpersonal bonds
No repayment
Offer suggestions re: management of business
Repayment: interest
Repayment: principal
Canada small business financing
Stock and shares

Financing options pros and cons

Review sheet

Equity capital	
Pros	Cons

Venture capitalist	
Pros	Cons

Stock sales	
Pros	Cons

Financing options pros and cons (cont'd)

Debt capital	
Pros	Cons

Personal savings	
Pros	Cons

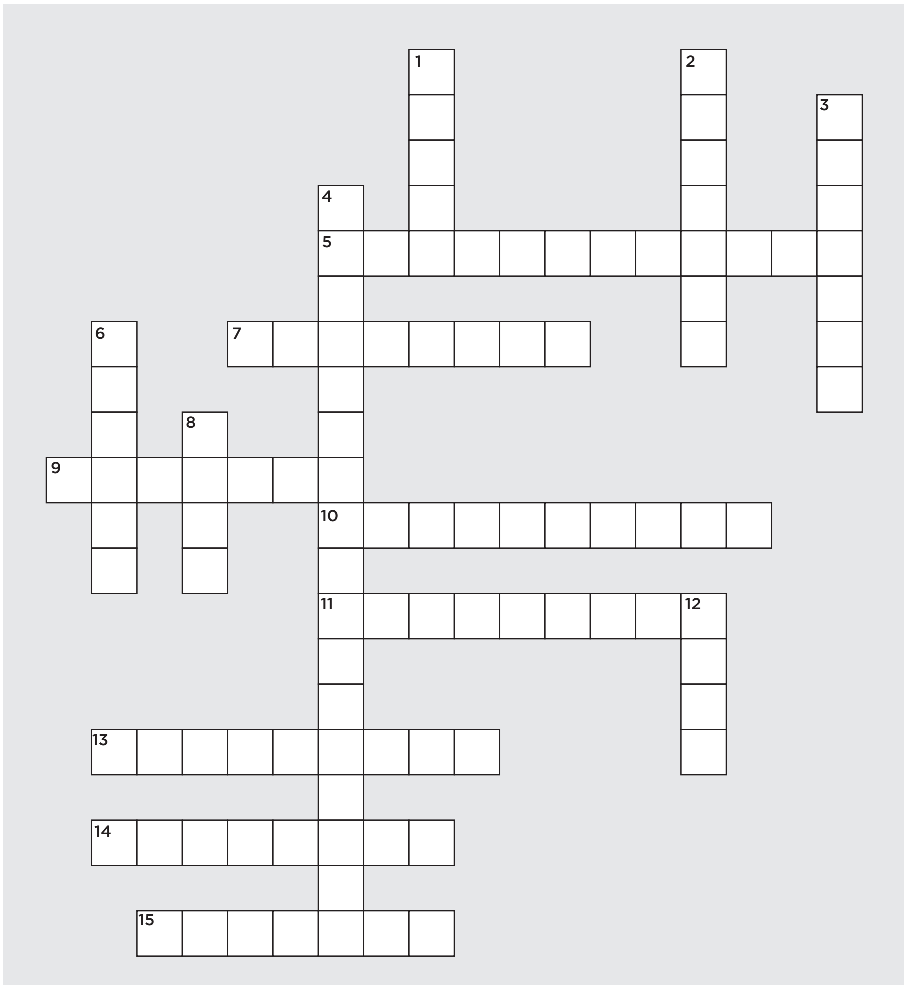
Friends and relatives	
Pros	Cons

Financing options pros and cons (cont'd)

Bank	
Pros	Cons

Government sponsored agencies and programs	
Pros	Cons

Crossword puzzle



Across

5. A business-minded individual.
7. Repaid on principal owed.
9. To raise or supply money.
10. A loan secured by property.
11. A capital sum lent or borrowed.
13. Restrictions placed on debt financing.
14. Ability to reay loan.
15. Stocks or assets used for carrying on a business.

Down

1. Anything owned that has value.
2. Personal money put away for future use.
3. A risky business.
4. Someone willing to put capital into your business
6. Ownership in a company.
8. Primary lender for small business.
12. A sum owing, an obligation.