Chapter 2. New Venture Financing: Considerations and Choices

Questions and Problems

1. Discuss how you would expect the financing choices of the following firms to differ and explain the reasons for the differences.
    a. An early-stage research and development venture, compared to an established venture that is generating revenue.
    b. A venture with revenues that are growing very rapidly and must expand its working capital base to match, compared to a venture with revenues that are growing at the inflation rate.
    c. A venture that is highly profitable and growing, compared to a venture that is growing at a similar rate but has not yet achieved profitability.
    d. A venture that is organized as a C corporation, compared to one that is organized as an S corporation.
    e. A new venture that is being launched by an entrepreneur who has a significant track record of new venture successes, compared to a venture that is being undertaken by an entrepreneur with no previous new venture experience.
    f. A venture that requires large investment in tangible assets, compared to one with assets that are mostly intangible.
2. What are the advantages and disadvantages of the following financing/organizational choices?
    a. A corporate strategic partner
    b. Factoring of accounts receivable
    c. Crowdfunding
    d. Venture capital
    e. Franchising
    f. Postponing payment of accounts payable
    g. A secured loan
    h. Licensing
    i. Direct public offering
    j. Initial public offering
3. Give three examples of bootstrap financing. Why do you think this type of funding is widely used by entrepreneurs when they start ventures?
4. How do the following considerations affect the choice of financing?
    a. Expected growth is high, but growth prospects are highly uncertain.
    b. The venture's continuing financial health is important to customers and suppliers.
    c. Employees the venture needs to hire are not highly skilled or are not specialized to the venture.
    d. The venture's financing needs are volatile and unpredictable.

5. Use the Internet to locate some Web sites of venture capital firms and business angel groups. Based on your search, what are the characteristics of investments sought by these two types of investors? What are the main differences in investment characteristics between angel groups and VCs? What differences in investment objectives, if any, do you see within each type?
6. One advantage of franchising is that the franchiser set standards for product quality and service. In the case of fast food franchising, some standards are left to the individual franchisee to decide. Predict the types of decisions that are left to the individual franchisee and those that are likely to be determined by the franchiser.
7. Name three factors an entrepreneur should consider when contemplating venture capital funding.
8. Describe some of the ways Alphabet/Google fosters innovation within the company. Has it been successful, and if so, why?
9. Your company is going to purchase $10,000 of raw material from a new supplier. The supplier offers you terms of 1/15, net 45. That is, if you pay within 15 days, you get a 1% discount. If not, the total amount is due in 45 days.
    a. How much will you owe the supplier if you pay on day 10?
    b. What is the implicit interest rate if you forgo the discount and pay on day 45 instead of day 15?
10. A firm has a $100,000 account receivable it is considering factoring. It expects to collect the full amount in 60 days, but is in need of immediate cash. A bank offers a short-term loan of $85,000 secured by the receivable at 12% interest (1% per month). Alternatively, a factor will advance 85% of the receivable immediately, with a $15,000 reserve. The full receivable is collected in 60 days, from which the factor will deduct a 2.5% fee (i.e., $2,500). What should the company do?
11. Describe three benefits of “private placement” of debt or equity.
12. In some activities, such as education and healthcare, for-profit and not-for-profit enterprises compete with each other. What do you think it means for an enterprise to be organized as not-for-profit? Why do you think not-for-profits sometimes compete aggressively for business? As a prospective entrepreneur of a venture that could be organized as either, what factors do you think should bear on the choice? Explain.
13. When would you organize as an S Corporation instead of a C Corporation?
14. What is the meaning of “limited liability” in terms of total risk and risk allocation? If equity investors in a venture have limited liability, and the venture fails, how might the failure affect the equity investors, creditors, employees, suppliers, and customers? Do you think it would matter to the other stakeholders whether equity investors have limited liability? Why or why not?
15. Describe the exemptions to securities registration provided by Regulation D. What is the maximum amount a company could raise in a 12-month period if only some of their investors were “sophisticated”? (You can read more about the U.S Securities and Exchange Commission’s Reg. D on the Internet.)