CHAPTER

08

FINANCE A NEW VENTURE

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Chapter 8

Finance a New Venture

Raising capital is the fuel that converts an entrepreneurial idea into a functioning business. But capital does not arrive because the idea is good — it arrives because the entrepreneur has done the analytical work to know exactly how much is needed, what it will be used for, when it will be repaid or generate returns, and which source of capital is best suited to their specific venture and circumstances. This chapter provides a comprehensive framework for identifying capital requirements, evaluating funding options, compiling the personal financial statements that lenders require, and navigating the process of obtaining finance in the South African context.

By the end of this chapter, you will be able to:

✥ Explain the six steps in raising finance for a new venture.
✥ Define and distinguish between the three forms of capital requirements: pre-start-up, operational phase, and personal living expenses.
✥ Calculate fixed asset requirements using the percentage-of-sales method.
✥ Identify and calculate pre-operating costs for a new venture.
✥ Compile a projected cash flow statement for a new venture.
✥ Apply five key financial ratios to assess the financial viability of a new venture.
✥ Calculate the break-even point for a new venture and explain its significance to investors.
✥ Define and distinguish between debt financing and equity financing.
✥ Explain the advantages and disadvantages of debt financing.
✥ Explain the advantages and disadvantages of equity financing.
✥ Describe venture capital and angel investment as equity funding sources.
✥ Identify and explain five alternative funding sources: personal savings, family and friends, credit cards, government grants, leasing, hire purchase, and franchising.
✥ Compare leasing and hire purchase as methods of acquiring fixed assets.
✥ Explain the concept of franchising and its advantages and disadvantages for the franchisor and franchisee.
✥ Identify South African funding institutions and the types of businesses they serve.
✥ Identify and explain the challenges new ventures face in accessing debt and equity financing.
✥ Compile a personal income and expenditure statement.
✥ Compile a personal assets and liabilities statement and calculate net worth.
✥ Explain the collateral requirements for accessing bank finance.
✥ List the documentation required when applying for business finance.
✥ Describe how banks process finance applications.
✥ Apply the criteria for selecting the most appropriate funding option for a specific venture.
✥ Explain the key legislation governing financial services in South Africa: FICA and POCA.

Section 1: Identifying Capital Requirements

Before approaching any investor or lender, the entrepreneur must know with precision how much capital the venture needs, what it will be used for, when it will be needed, and what return or repayment the capital provider can expect. Vague or poorly researched capital requirements are one of the most common reasons new venture funding applications are rejected — not because the business idea is bad, but because the entrepreneur has not done the analytical work that gives the lender confidence.

1.1 The Six Steps in Raising Finance

Raising capital is a process, not an event. Entrepreneurs who approach it systematically are far more likely to succeed than those who walk into a bank with a verbal pitch and a vague idea of what they need:

Step 1: Determine Exactly How Much You Need

Before approaching any investor or lender, complete a rigorous capital requirements analysis that covers all three categories: pre-start-up costs, initial operational capital, and personal living expense provision. Express the total as a precise figure with a detailed schedule of how each rand will be deployed. Vague requests ('we need about R500,000') signal poor planning and reduce investor confidence.

Step 2: Identify the Most Suitable Funding Sources

Different funding sources are appropriate for different types of capital needs, different business stages, and different risk profiles. Match the funding source to the nature of the need: long-term fixed assets should be financed with long-term capital (loans or equity); short-term working capital should be financed with short-term facilities (overdraft, invoice financing). Conduct a cost-benefit analysis of each available source before selecting.

Step 3: Prepare the Business Plan

The business plan is your primary sales document when raising capital. It must demonstrate a deep understanding of the market opportunity, a credible operational approach, a competent and committed team, and a financial model that shows how the capital will generate sufficient returns to repay loans and reward investors. The plan must be tailored to the specific interests of the target funder — banks focus on cash flow and security; equity investors focus on growth and exit; development finance institutions focus on developmental impact.

Step 4: Present the Plan Professionally

A presentation opportunity is not a formality — it is a high-stakes sales event. Know your numbers. Be able to answer any question about your projections, your market research, your cost assumptions, and your competitive analysis. Demonstrate passion and competence in equal measure. Be concise: investors have seen hundreds of plans; respect their time.

Step 5: Address Concerns and Objections

Investor questions and concerns are a positive signal — they indicate genuine interest and due diligence, not hostility. Prepare for the most likely objections in advance: market size and competition, team capability gaps, financial projection assumptions, technology risk, regulatory barriers, exit strategy. Respond with data and thoughtfulness, not defensiveness.

Step 6: Negotiate and Close

The initial offer from a lender or investor is rarely the final terms. Understand the market for the type of capital you are raising (typical interest rates, typical equity dilution for angel rounds, typical repayment terms for development finance) so that you can negotiate from knowledge rather than desperation. Never accept the first offer without understanding whether it is reasonable — and never negotiate terms you do not fully understand without professional legal or financial advice.

1.2 Forms of Capital Requirements

A new venture requires capital for three distinct purposes, each with different characteristics, timing, and appropriate funding sources:

Pre-Start-Up Capital

Pre-start-up costs are incurred before the business opens its doors — during the planning, registration, and set-up phase. These costs must be financed entirely from the entrepreneur's own resources or a committed start-up investor, because they are spent before any revenue is generated.

Common pre-start-up costs include: business registration with CIPC (R175-R750), professional fees (attorney for company registration, accountant for tax registration, consultant for business plan — typically R10,000-R50,000), market research costs (surveys, focus groups — R5,000-R30,000), regulatory licences and permits (variable by industry), lease deposit and advance rental (typically 2-3 months deposit), initial marketing collateral (website, branding, signage — R15,000-R80,000), and any intellectual property registration (trademark, patent — R5,000-R20,000).

Initial Operational Capital

Operational capital funds the business from launch until it reaches the cash flow break-even point — the month when customer receipts first cover all cash outflows on a sustained basis. This is typically the largest and most critical capital need, and it is consistently underestimated by new entrepreneurs.

Operational capital covers two sub-categories: fixed assets (equipment, furniture, vehicles, IT infrastructure, leasehold improvements — these are capital expenditures that become long-term business assets) and working capital (the cash needed to fund day-to-day operations during the start-up period — stock, supplier payments, staff wages, utilities, and other overhead costs that must be paid before customer receipts arrive in sufficient volume to cover them).

A conservative rule of thumb for working capital requirement: multiply average monthly operating expenses by the number of months projected until cash flow break-even, then add a 25-30% buffer for unexpected costs and delays. Most businesses take longer to reach break-even than initially projected.

Personal Living Expense Provision

Many new entrepreneurs forget to include their own personal financial needs in the capital requirement calculation — particularly sole proprietors and partners who cannot pay themselves a salary until the business generates sufficient profit.

The personal living expense provision covers: household bond or rent, food and utilities, vehicle costs, education, healthcare, personal insurance, and a contingency buffer for unexpected personal expenses (illness, car repairs, emergency travel). This provision should be calculated generously — underestimating personal financial needs creates pressure that forces entrepreneurs to make business decisions driven by personal cash flow rather than business logic.

1.3 Calculating Fixed Asset Requirements

Fixed assets are the durable, long-term assets required to operate the business — equipment, vehicles, furniture, computer systems, and leasehold improvements. They are financed from long-term capital (loans or equity) and depreciated over their useful lives. Two approaches are used to estimate fixed asset requirements:

Approach 1: Direct Identification

List every fixed asset the business will require at launch and at key growth milestones. For each asset, specify: the exact item and specification, the quantity required, the estimated cost (obtain actual quotes where possible), the expected useful life, the depreciation method (straight-line or reducing balance), and whether you will purchase or lease. Total the purchase costs to determine the fixed asset capital requirement.

Example — Tony's Trailer Hire Business (Gauteng):

Asset	Quantity	Unit Cost	Total Cost	Classification
Trailers	6	R20,000	R120,000	Fixed Asset (Revenue-generating)
Computer and software	1	R3,000	R3,000	Fixed Asset (Admin)
Office furniture	Set	R5,000	R5,000	Fixed Asset (Admin)
Total Fixed Assets			**R128,000**	
Monthly Operating Costs			**R14,800/month**	Fixed+Variable

Approach 2: Percentage-of-Sales Method

When detailed asset identification is not yet possible, industry data on the ratio of assets to sales can be used to estimate total asset requirements. This approach recognises that asset needs are driven by sales — as revenue grows, asset requirements grow:

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Asset Requirement = Projected Sales × (Industry Assets-to-Sales Ratio)
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Katie Dalton's Trailer Craft example: Projected Year 1 sales = R250,000. Industry research shows assets typically run 60% of sales. Asset requirement = R250,000 × 60% = R150,000. Asset breakdown: Cash (5% of sales) = R12,500; Accounts receivable (10%) = R25,000; Inventories (25%) = R62,500; Fixed assets (equipment, direct estimate) = R50,000. Total = R150,000.

1.4 Calculating Pre-Operating Costs

Pre-operating costs are incurred before the business begins generating revenue. They are one-time expenditures that must be funded from start-up capital. They cannot be recovered from sales until the business is operational, so they must be fully financed upfront.

Common pre-operating cost categories for South African new ventures:

Category	Typical Range
Business Registration	CIPC registration fee (R175 online), name reservation (R50 online), professional fees for attorney or accountant to assist with registration and tax registration (R2,000-R15,000)
Market Research	Customer surveys, competitor analysis, focus groups, and any professional market research (R5,000-R50,000 depending on scope and method)
Premises Set-Up	Lease deposit (typically 2 months), advance rental, leasehold improvements, signage, and painting (variable — R20,000-R500,000+ for retail)
Equipment Installation	Delivery charges, installation labour, and commissioning of equipment (variable by type)
Marketing Launch	Website development, branding, initial marketing materials, social media setup, opening event (R10,000-R100,000+)
Legal and Professional	Contract drafting (supplier, customer, employment), IP registration, regulatory licences (R5,000-R50,000)
Staff Recruitment and Training	Advertising, recruitment fees, pre-opening training costs (R5,000-R30,000)
Stock and Inventory Build	Initial inventory purchase before first sale (variable — can be very large for retail and manufacturing)

1.5 The Projected Cash Flow Statement

The cash flow statement is the most important financial document for a new venture — more important even than the income statement. A business can be profitable (in accounting terms) while simultaneously running out of cash — because profit is measured on an accrual basis (when invoiced) but cash flow is measured when money actually moves. A new venture that runs out of cash fails, even if its underlying business model is profitable.

Why Cash Flow Differs from Profit

Timing differences: You may invoice a customer in March but only receive payment in June (60-day terms). You show the revenue in March but only receive the cash in June.

Capital expenditures: Buying a R100,000 machine is a cash outflow that doesn't appear on the income statement as an expense — it appears as depreciation spread over years.

Loan repayments: Repaying a loan is a cash outflow but is not an income statement expense (only the interest is an expense).

Stock build: Purchasing stock is a cash outflow, but only becomes an income statement expense (cost of goods sold) when the stock is sold.

VAT timing: VAT collected from customers must be paid to SARS on specific dates — creating cash outflows that precede or follow the related transactions.

Structure of the Projected Cash Flow Statement

A monthly cash flow projection for Year 1 should include:

Opening bank balance: Cash on hand and in bank at the start of the month

Cash inflows: Cash sales receipts; collections from debtors (credit sales paid in prior months); loan proceeds; investor contributions; any other cash received

Total cash available: Opening balance plus all cash inflows

Cash outflows: All cash payments: stock/material purchases; staff wages; rent; utilities; advertising; accounting; insurance; vehicle costs; loan repayments; VAT payments; owner drawings; equipment purchases; any other cash paid out

Closing bank balance: Total cash available minus total cash outflows — this is the cash position at month end

The closing balance of one month becomes the opening balance of the next. Months with negative closing balances indicate when the business will need additional funding — either from a pre-arranged overdraft facility, additional equity injection, or accelerated collections from debtors. Identifying these funding gaps in advance — before they become crises — is the primary purpose of the cash flow projection.

1.6 Assessing Financial Viability with Ratios

Financial ratios translate the raw numbers of financial statements into comparative measures that reveal the health of the business. Investors and lenders use these ratios to assess whether a new venture is financially viable:

Ratio	Formula	What It Measures	Healthy Range
Working Capital	Current Assets – Current Liabilities	Absolute liquidity surplus	Positive and growing
Current Ratio	Current Assets ÷ Current Liabilities	Ability to meet short-term obligations	1.5:1 to 2.5:1
Quick (Acid Test) Ratio	(Current Assets – Inventory) ÷ Current Liabilities	Immediate liquidity (excluding slow-moving stock)	1:1 or better
Debt-to-Equity Ratio	Total Liabilities ÷ Shareholders' Equity	Financial leverage and risk level	Below 2:1 for most SMEs
Receivables Turnover	Net Credit Sales ÷ Average Receivables	Speed of collecting from customers	Higher is better (faster collection)
Average Collection Period	365 ÷ Receivables Turnover	Average days to collect from customers	Below 30 days ideally; depends on terms
Inventory Turnover	COGS ÷ Average Inventory	Speed of selling through inventory	Higher is better (less capital tied up)
Days Inventory Outstanding	365 ÷ Inventory Turnover	Average days stock sits before being sold	Depends heavily on sector

1.7 Break-Even Analysis for New Venture Finance

Every investor and lender will ask: 'When does this business become profitable?' The break-even analysis answers this question with mathematical precision and demonstrates financial literacy that builds investor confidence.

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Break-Even Units = Total Fixed Costs ÷ (Selling Price per Unit – Variable Cost per Unit)
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Comprehensive Break-Even Example — Oakcrest Products:

Fixed costs = R150,000. Selling price per unit = R125. Variable cost per unit = R62.50.

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Break-even units = R150,000 ÷ (R125 – R62.50) = R150,000 ÷ R62.50 = 2,400
units Break-even revenue = 2,400 × R125 = R300,000
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This means Oakcrest must sell 2,400 units before generating any profit. Every unit beyond 2,400 generates R62.50 of pure profit (the full contribution margin). If Oakcrest projects selling 3,000 units in Year 1: Margin of safety = 3,000 – 2,400 = 600 units (25% above break-even). Projected profit = 600 × R62.50 = R37,500.

Section 2: Funding Options for New Ventures

Having determined the capital requirements, the entrepreneur must select the most appropriate funding sources. There is no single best funding source — the optimal capital structure depends on the stage of the business, the nature of the assets being financed, the entrepreneur's risk tolerance, and the terms available from different providers. Understanding the full range of options enables an informed choice rather than a default to the first option that presents itself.

2.1 Debt Financing — Borrowing Capital

Debt financing involves borrowing money that must be repaid over a defined period with interest. The lender does not acquire any ownership in the business — their interest is solely in recovering the principal plus interest within the agreed timeframe. Debt financing is the most common form of external financing for South African SMEs.

Forms of Debt Financing

Short-Term Debt (Repayable within 12 months)

Used to finance working capital needs — stock purchases, debtor funding, seasonal cash flow gaps. Short-term debt instruments include: bank overdraft (a revolving credit facility secured against the current account — interest charged only on the amount drawn, repayable on demand), invoice discounting or factoring (selling receivables to a financier at a discount to accelerate cash collection — particularly useful for businesses with 30-60 day payment terms), trade credit (suppliers allow 30-90 day payment periods — effectively interest-free short-term financing), and short-term business loans (fixed term, typically 3-12 months, for specific working capital needs).

Medium-Term Debt (1-5 years)

Used to finance equipment, vehicles, and other assets with a useful life of 1-5 years. Medium-term instruments: term loans from commercial banks (fixed monthly repayments over 2-5 years, secured against the asset financed), hire purchase agreements (the business uses the asset immediately while paying for it in instalments — ownership transfers when the final payment is made), and equipment leasing (the lessor owns the asset and the business pays lease rentals — effectively renting the asset for a defined period).

Long-Term Debt (Over 5 years)

Used to finance property, major infrastructure, and business acquisitions. Long-term instruments: commercial mortgage bonds (secured against property, typically 10-20 year terms), development finance institution loans (IDC, SEFA, NEF — typically longer terms and lower rates than commercial banks for qualifying businesses), and government-backed guarantees (Khula Credit Guarantee Scheme — enables banks to lend to businesses that lack sufficient collateral by providing a government guarantee).

Advantages and Disadvantages of Debt Financing

Advantages of Debt	Disadvantages of Debt
✓ No dilution of ownership — the entrepreneur retains full control	✗ Must be repaid regardless of business performance
✓ Interest payments are tax-deductible (reduces after-tax cost of debt)	✗ Interest payments reduce cash flow, especially in early months
✓ Once repaid, no ongoing obligation to the lender	✗ Requires collateral — difficult for asset-light businesses
✓ Repayment schedule provides financial discipline	✗ Excessive debt increases financial risk and reduces credibility with equity investors
✓ Widely available through commercial banks and DFIs	✗ Covenants may restrict business decisions
✓ Forces the entrepreneur to build a credit history	✗ Personal suretyship puts the entrepreneur's personal assets at risk

2.2 Equity Financing — Selling Ownership

Equity financing involves selling an ownership stake in the business in exchange for capital. Unlike debt, equity does not require repayment on a fixed schedule. Instead, equity investors participate in the upside of the business — sharing in profits and ultimately receiving their return when they sell their stake. Equity financing is the preferred option for businesses with high growth potential and uncertain near-term cash flows.

Sources of Equity Financing

Founder Capital (Bootstrapping)

The entrepreneur's own savings and assets invested in the business. This is the most common source of equity for new ventures and signals commitment to other investors. A founder who has invested their own money at risk is far more credible to external investors than one seeking to build a business entirely with other people's money. The South African government's Enterprise Development programmes typically require a minimum own-contribution (often 10% of the total requirement) as a condition of support.

Friends and Family

Investment from people in the entrepreneur's personal network who trust the entrepreneur and believe in the opportunity. This is often the first external equity available to a new venture before formal investors will consider it. Friends and family investment should always be formalised in writing — with a clear statement of whether it is a loan or equity, what the terms are, and what happens if the business fails. The informal nature of these arrangements is the most common source of personal relationship damage in entrepreneurship.

Angel Investors

High-net-worth individuals who invest their own capital in early-stage ventures in exchange for equity, typically between R200,000 and R5,000,000. Angels provide not only capital but also industry expertise, strategic advice, and professional networks. They typically invest in sectors they know well.

Advantages of angel investment: accessible for pre-revenue or early-revenue businesses; angels often take a hands-on mentorship role; flexible investment criteria; faster decision-making than institutional investors.

Disadvantages: angels acquire an ownership stake and a voice in the business; some angels overestimate the value of their advice; finding the right angel requires access to networks that many entrepreneurs lack; angels may expect returns of 5-10x over 5-7 years — creating exit pressure.

Venture Capital

Professional investment firms that raise and deploy capital on behalf of institutional investors (pension funds, endowments, sovereign wealth funds). Venture capital firms typically invest R5,000,000 and above, focus on high-growth-potential businesses, and have sophisticated due diligence processes.

Venture capital is appropriate only for businesses with genuinely large market opportunities, scalable business models, and a credible path to a liquidity event (acquisition or public listing) within 5-7 years. Most South African SMEs are not appropriate candidates for venture capital — but understanding what VCs look for helps entrepreneurs assess their own venture's growth potential.

Advantages and Disadvantages of Equity Financing

Advantages of Equity	Disadvantages of Equity
✓ No repayment obligation — frees cash flow for operations and growth	✗ Dilution of ownership — the entrepreneur owns less of the business
✓ No interest cost — reduces fixed cost burden in early stages	✗ Investors acquire a say in business decisions
✓ Sophisticated investors bring expertise and networks beyond capital	✗ Expectations of high returns create pressure on the business
✓ Shared risk — investors absorb losses proportional to their stake	✗ Exit requirements may conflict with the entrepreneur's plans
✓ Can signal credibility and quality if investor is well-regarded	✗ Equity is typically more expensive than debt (higher expected return)

Debt-to-Equity Ratio — Finding the Right Balance

Most businesses use both debt and equity in their capital structure. The debt-to-equity ratio (Total Liabilities ÷ Shareholders' Equity) measures the balance between borrowed and owned capital. A ratio of 1:1 means the business owes as much as the owners have invested; 2:1 means the business owes twice as much as the owners have invested. General guidance: early-stage businesses should rely more heavily on equity (because uncertain cash flows make debt repayment risky); established businesses with predictable cash flows can carry more debt (using the lower-cost debt to increase returns on equity). Most lenders expect an own contribution of at least 30-40% of total capital (implying a maximum debt-to-equity of approximately 2:1).

2.3 Alternative Funding Sources

Beyond traditional bank debt and formal equity investment, several alternative funding sources are available to South African new ventures:

Personal Savings and 'Nest Eggs'

The most accessible funding source and the strongest signal of commitment to external investors. Personal savings include: bank savings accounts, retirement annuity withdrawals (subject to tax and penalties), the cash value of endowment policies, proceeds from sale of personal assets (vehicles, property, investments). Re-mortgaging a personal property to release equity is also a common source of start-up capital, though it creates significant personal financial risk — if the business fails, the property may be lost.

Credit Cards

Surprisingly common for small business start-ups. Credit cards provide access to a revolving credit facility with a 30-45 day interest-free period. They are most useful for small, short-term purchases — supplies, software subscriptions, travel — that will generate revenue before the card statement is due. As a primary source of business financing, credit cards are expensive (interest rates of 15-22% per annum) and limited in quantum. Never use credit cards to finance fixed assets.

Government Grants and Programmes

South Africa offers a range of government-funded support programmes for new and emerging entrepreneurs. Unlike loans, grants do not need to be repaid — making them a highly attractive source of capital where the business qualifies.

Key South African government funding sources: Small Enterprise Finance Agency (SEFA — loan and loan guarantee funding for businesses with turnover below R50 million), Small Enterprise Development Agency (SEDA — business development support and incubation), National Empowerment Fund (NEF — equity and debt funding for black-owned businesses), Industrial Development Corporation (IDC — debt and equity for industrial and commercial projects), and National Youth Development Agency (NYDA — funding and support for youth entrepreneurs 18-35 years old).

Government grants typically come with strict spending conditions and oversight requirements. Application processes are often lengthy and bureaucratic. Competition is intense. But for qualifying businesses, the non-repayable nature of grant funding makes the application process well worth the effort.

Leasing

Leasing allows the business to use an asset without purchasing it. The lessor (owner of the asset) rents it to the lessee (the business) for a periodic payment over a defined term. Leasing is an effective strategy for conserving capital — freeing up cash that would otherwise be tied up in asset ownership.

Two forms of lease: Operating leases (short-term rental arrangements where the lessor maintains the asset; the lessee can return it or upgrade at the end of the term — common for vehicles, printers, and technology equipment); Finance leases (long-term arrangements covering most of the asset's useful life, after which the lessee may purchase the asset for a nominal sum — effectively a loan secured against the asset).

Advantages of leasing: preserves capital; payments are an operating expense (tax-deductible); technology can be upgraded at lease end; no collateral required beyond the asset itself. Disadvantages: higher total cost than purchase if used for long periods; the business never owns the asset.

Hire Purchase

Hire purchase (HP) is similar to leasing in that the business uses the asset immediately while paying for it over time — but different in a critical respect: ownership of the asset transfers to the business when the final instalment is paid. HP arrangements typically require an initial deposit (10-30% of the asset value) and fixed monthly instalments over an agreed term.

HP is commonly used for vehicles, equipment, and machinery. The interest rate is typically embedded in the monthly payment (flat rate, which understates the effective annual interest rate). Calculate the true cost of HP financing before committing — the effective interest rate can be significantly higher than a comparable bank loan.

Franchising

Franchising is a method of expanding a business through external capital — specifically, the capital of the franchisee. From the franchisee's perspective, franchising provides access to a proven business model, an established brand, training and support systems, and a supply chain, at the cost of an initial franchise fee and ongoing royalties (typically 5-10% of turnover).

South African franchise brands: Nando's, Steers, Spur, Chicken Licken, Wimpy, Debonairs, King Pie — many of South Africa's most successful food businesses operate on franchise models.

For the entrepreneur considering buying a franchise: the franchise fee and start-up costs must be financed (often R500,000-R3,000,000 for established brands); the franchisor typically assists with or facilitates bank financing; the business operates with significantly less autonomy than an independent venture; but the risk profile is substantially lower due to the proven model.

2.4 South African Funding Institutions

A wide range of institutions provide funding to South African new ventures. Understanding which institution is best suited to your venture's profile, stage, and sector is critical to a successful funding approach:

Institution	Type of Funding	Target Businesses
SEFA (Small Enterprise Finance Agency)	Loans and loan guarantees; microfinance	SMMEs with turnover up to R50m; startups and established businesses
IDC (Industrial Development Corporation)	Equity, quasi-equity, and debt	Industrial, commercial, and BEE projects; mainly R1m+
NEF (National Empowerment Fund)	Equity and debt for BEE transactions	Black-owned and black-empowered businesses

Land Bank	Agricultural finance	Small to large-scale farmers and agribusinesses
NYDA (National Youth Development Agency)	Grants and loans for youth entrepreneurs	Entrepreneurs aged 18-35
Khula Credit Guarantee	Loan guarantees (enables bank lending to under-collateralised businesses)	Small and medium enterprises lacking collateral
Commercial Banks (Big Four)	Term loans, overdrafts, asset finance, trade finance	All business stages; require credit history and collateral
Business Partners	Equity, quasi-equity, and debt	SMEs in formal sectors; R500,000 to R50m
SEDA (Small Enterprise Development Agency)	Business development support; incubation; mentorship	Early-stage businesses needing support beyond capital

2.5 Challenges Facing New Ventures in Accessing Finance

South African new ventures face a range of structural and practical challenges in accessing financing. Understanding these challenges enables proactive strategies to overcome them:

Debt Financing Challenges

◆ Lack of trading history: Banks require 2-3 years of financial statements to assess credit risk. A new venture has no history.

◆ Insufficient collateral: Most new ventures lack the tangible assets that banks accept as security. The entrepreneur's personal property often becomes the only viable collateral.

◆ Uncertainty premium: Lenders charge higher interest rates to new ventures to compensate for higher default risk — increasing the cost of capital precisely when margins are tightest.

◆ Entangled position: Banks may require additional equity before extending more debt — but the entrepreneur may not have additional equity to contribute.

◆ Personal suretyship: Banks typically require the directors to sign personal suretyships for business loans, putting personal assets at risk.

Equity Financing Challenges

◆ Equity gap: For the R500,000-R5,000,000 range, there are relatively few investors — too large for friends and family, too small for most institutional investors.

◆ Lack of investor networks: Angel investors and venture capitalists operate through networks that many entrepreneurs — particularly those from disadvantaged backgrounds — cannot access.

◆ Market trust deficit: Equity markets have limited confidence in early-stage ventures without proven business models and revenue traction.

◆ Exit route limitation: Investors who cannot identify a realistic exit strategy (typically within 5-7 years) are reluctant to invest.

◆ Governance requirements: Equity investors typically require board representation, information rights, and approval rights over major decisions — reducing the entrepreneur's operational autonomy.

Section 3: Personal Financial Statements

When a new venture owner applies for business financing, most lenders require personal financial statements alongside the business plan. These statements demonstrate the entrepreneur's personal financial health — their income capacity to service debt, their asset base as potential collateral, and their personal financial discipline as a proxy for their business financial management capability.

3.1 The Personal Income and Expenditure Statement

The personal income and expenditure statement shows the entrepreneur's personal monthly or annual income and how it is spent. It demonstrates whether the entrepreneur has sufficient personal income to meet their living expenses without depending entirely on the new business for personal survival — which is critical because a financially stressed entrepreneur makes poor business decisions.

Components of Personal Income

Income includes all money received that adds to financial resources:

- Employment salary or wages (after tax)
- Business drawings or directors' remuneration from existing businesses
- Rental income from investment properties
- Investment income (dividends, interest on savings and investments)
- Social grants or pension income
- Freelance or consulting income
- Any other regular income

Components of Personal Expenditure

Expenditure includes all money paid out for personal living expenses:

- Bond repayment or rent
- Food and groceries
- Clothing and personal care
- Vehicle costs (fuel, insurance, repayments)
- Water and electricity
- Medical aid and healthcare
- Education costs (children's school fees, own study)
- Entertainment and dining out
- Communication (phone, internet)
- Insurance (life, disability, household, car)

- ◆ Domestic worker salary
- ◆ All debt repayments (loans, credit cards, store accounts)

Example: Nothando's Personal Income Statement

FBC Bank requires Nothando to provide a personal income statement when applying for a R12,000/year loan (R1,000/month). The bank needs to confirm she has sufficient surplus income to service the loan:

Item	Annual Amount
Annual Salary (after tax)	R100,000
TOTAL INCOME	**R100,000**
Bond repayment	R30,000
Food and groceries	R20,000
Clothing	R5,000
Water and electricity	R2,000
Telephone	R5,000
Entertainment	R4,000
TOTAL EXPENDITURE	**R66,000**
SURPLUS (Income minus Expenditure)	**R34,000**

Surplus = R34,000/year (R2,833/month). Since the loan requires R1,000/month, Nothando can comfortably service the loan — the surplus is 2.8 times the repayment. The bank is satisfied and can proceed with the application.

3.2 Personal Assets and Liabilities Statement

The personal assets and liabilities statement (also called the personal balance sheet or net worth statement) reveals the entrepreneur's total financial position — what they own minus what they owe. Net worth is the single most comprehensive measure of an individual's financial health, and it is closely scrutinised by lenders assessing collateral and banks evaluating personal suretyship.

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Net Worth = Total Assets − Total Liabilities
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Assets to Include

Fixed/Immovable Property: Market value of all residential and commercial properties owned. Use current market value, not original purchase price.

Vehicles: Current market value (not book value) of all vehicles owned personally.

Cash and Bank Balances: Current account balance, savings account balance, money market account balance.

Investments: Market value of shares, unit trusts, retirement annuity funds (surrender value), endowments, and other investment accounts.

Receivables: Any money owed to you by third parties — clients, friends, family — that you expect to recover.

Personal Effects: Estimated value of furniture, jewellery, and other significant personal possessions.

Liabilities to Include

Mortgage Bonds: Outstanding balances on all property loans.

Vehicle Finance: Outstanding hire purchase or lease balances.

Personal Loans: Any term loans, personal credit facilities, or family loans.

Credit Card Balances: Outstanding balances on all credit cards.

Store Account Balances: Outstanding balances on all retail credit accounts.

Any Other Debts: Student loans, tax arrears, legal judgements, and any other outstanding obligations.

When Personal Financial Statements Are Required

◆ When applying for a business loan — the bank assesses both business and personal financial health

◆ When providing personal suretyship for a business loan — the bank assesses the value of the surety

◆ When completing a SARS income tax return

◆ When applying for government support programmes that assess the entrepreneur's financial position

◆ For personal financial planning and net worth tracking

◆ When entering into significant financial commitments that require proof of financial capacity

Section 4: Requirements and Process of Obtaining Finance

Understanding the lender's perspective — what they need to see, what concerns they will raise, and how they assess applications — dramatically improves the entrepreneur's probability of funding success. This section demystifies the finance application process and explains the legal framework within which financial services operate in South Africa.

4.1 Collateral Requirements

Collateral is a tangible, specific asset pledged to a lender as additional security for a loan. If the borrower defaults, the lender can sell the collateral to recover the outstanding loan balance. Understanding what qualifies as acceptable collateral is essential for loan application planning:

Immovable Property (Real Estate)

The most widely accepted and most valuable form of collateral. A first mortgage bond registered over property gives the lender a first claim on the property in the event of default. The lender will value the property independently and typically lend 60-80% of the assessed value (the loan-to-value ratio). Properties owned by the entrepreneur personally, by the business, or by a co-signer can all serve as collateral for business loans.

Movable Property (Equipment, Vehicles, Inventory)

Equipment, vehicles, and other movable assets can be pledged as collateral through a notarial bond. The lender registers a security interest over the asset — if the borrower defaults, the lender can take possession and sell the asset. Movable property is generally less attractive collateral than real estate because it depreciates, can be moved, and is harder to value independently.

Shares and Financial Instruments

Listed shares, unit trusts, and other financial instruments can be pledged as collateral through a cession in security. The lender holds the certificates or takes a security notation on the account. The challenge is that financial instruments can decline in value — reducing the security available to the lender.

Intellectual Property

Registered trademarks, patents, and copyrights can be pledged as collateral, though they are less commonly accepted and more difficult to value. The value depends entirely on the commercial viability of the IP — which can be difficult to assess independently.

Cession of Debtors (Debtor Book)

A business can cede (transfer) its right to collect from customers to the lender as security. This is particularly useful for invoice financing and factoring arrangements. The lender essentially takes the position of the business in collecting from its customers.

4.2 Bank Loan Application Requirements

A bank loan application for a new venture typically requires the following documentation. Incomplete applications are the most common cause of delay — assemble all documents before submitting:

Document	Description
Business Plan	Complete business plan including market analysis, financial projections (3-5 years), management profiles, and competitive analysis
Monthly Cash Flow Projection	Month-by-month cash flow for at least 36 months
Capital Expenditure Budget	Planned capital purchases for the next 2 years with quotes
Personal Balance Sheet	Personal assets and liabilities statement for all shareholders
CVs of All Shareholders	Detailed curriculum vitae including relevant experience
Shareholder Financial Contributions	Details of each shareholder's cash and asset contribution to the venture
For Franchise Applications	Franchise agreement, disclosure document, operations manual, franchisor's financial history
Identity Documents	Certified copies of ID documents for all directors and shareholders
Proof of Address	Utility bills or bank statement showing current residential address
Bank Statements	Last 6 months' personal bank statements for all shareholders
VAT Returns	Last 6 months' VAT returns (if existing business)
Lease Agreement	Signed lease agreement for business premises (or proof of ownership)
Asset Register	List of all business assets with estimated values
Customer Contracts	Signed customer contracts or letters of intent supporting revenue projections

4.3 How Banks Assess New Venture Loan Applications

Understanding what the bank is looking for in each section of your application enables you to address their concerns proactively rather than waiting for them to surface as objections:

Who Are You?

The bank lends to people, not plans. Your track record, qualifications, character, and commitment are assessed first. A founder who has successfully managed a similar business is far less risky than one entering a completely unfamiliar sector. Your CV must demonstrate relevant experience. Your willingness to invest your own money is the most compelling evidence of belief in the venture.

Why Is the Business Viable?

The feasibility study must prove the business can generate sufficient profit over the medium to long term to service the loan and provide a return. The bank will examine: the market opportunity (is it real and large enough?), the competitive position (does the business have a sustainable advantage?), the management team (can they execute?), and the financial projections (are they realistic and can the business service the debt?).

How Much Do You Need and For How Long?

Vague funding requests destroy credibility. Specify the exact amount required, the purpose of each component, the repayment term requested, and the proposed repayment source (projected cash flow). Never present an estimate — present a precisely calculated requirement.

What Is Your Own Contribution?

Banks rarely fund 100% of a venture's capital requirements. They expect the entrepreneur to have 'skin in the game' — typically 30-40% own contribution. Your own investment demonstrates commitment and reduces the bank's risk. The larger your own contribution, the better the interest rate you can negotiate.

What Collateral Is Available?

The bank assesses the quality and value of collateral independently. They will commission their own property valuation, apply conservative loan-to-value ratios, and assess the ease of realisation in a default scenario. Strong collateral does not guarantee approval — cash flow is more important — but it does improve the terms.

What Are the Repayment Sources?

The primary repayment source for a business loan is the business's operating cash flow. The bank will stress-test the cash flow projections to ensure the business can service the debt even in less favourable scenarios — lower-than-projected revenue, higher-than-projected costs. Secondary repayment sources (personal income, collateral realisation) provide a backstop if the primary source fails.

4.4 The Bank's Application Processing Sequence

Once a complete application is submitted, the bank follows a structured assessment process:

1. Credit checks are run on all applicants, directors, and sureties — adverse credit history is a significant barrier

2. The business plan and all supporting documentation is reviewed and verified — inconsistencies are flagged

3. Financial projections are stress-tested against more conservative scenarios

4. If property is involved as security, an independent valuation is commissioned

5. The bank calculates its 'exposure' — the gap between the loan amount and the realisable value of security offered

6. The application is assessed by the relevant credit authority — dependent on loan amount

7. A decision is communicated — approval, conditional approval, or decline with reasons

8. Typical processing time: 2-6 weeks for complete applications; longer if documents are missing

4.5 Selecting the Optimal Funding Option

The optimal funding source is the one that best aligns with the specific capital need, the venture's stage, and the entrepreneur's goals. Use this decision framework:

Capital Need	Appropriate Funding Source	Why
Pre-start-up costs	Personal savings; family and friends; government grants	No revenue to service debt; lenders won't fund
Fixed assets (equipment, vehicles)	Asset finance (hire purchase or finance lease); medium-term bank loan	Asset serves as collateral; useful life matches loan term
Working capital (stock, debtors)	Overdraft; invoice financing; short-term loan; trade credit	Short-term, revolving need matches short-term facility
Property acquisition	Long-term commercial mortgage; development finance	Property serves as security; long asset life matches long loan term
Growth capital (market expansion)	Equity (angel, VC); retained earnings; development finance	Risk profile of growth appropriate for risk capital
Technology/IP development	Government grants; equity; R&D; tax incentives	Intangible asset hard to secure against; risk capital appropriate

4.6 Legislation Governing Financial Services

All financial service transactions in South Africa are governed by two key pieces of legislation that every entrepreneur must understand when dealing with banks and financial institutions:

FICA — Financial Intelligence Centre Act (38 of 2001)

FICA requires all financial institutions (banks, insurers, investment managers, stockbrokers) to verify the identity and residential address of every client. This is part of South Africa's obligations under international anti-money laundering and counter-terrorism financing frameworks.

Information FICA requires financial institutions to collect:

- ◆ Full legal name (as per identity document)
- ◆ Date of birth
- ◆ South African ID number (for citizens) or passport number and nationality (for foreign nationals)
- ◆ Physical residential address (not a PO Box)
- ◆ Contact details (telephone, email)

Acceptable FICA documents: green barcoded South African ID or Smart Card ID; valid passport; valid card-type driver's licence. For address verification: utility bill, bank statement, or lease agreement dated within the last 3 months and showing the physical address. Without FICA compliance, the financial institution cannot open an account, process a loan, or provide any financial service.

POCA — Prevention of Organised Crime Act (121 of 1998)

POCA is South Africa's primary anti-money laundering legislation. It criminalises the receipt, possession, or use of proceeds from unlawful activities — regardless of whether the person knew the money was derived from crime. Money laundering is the process of making illegally-obtained funds appear legitimate by passing them through normal financial channels.

A person is guilty of money laundering under POCA if they:

- ◆ Know or ought to have known that money or property derives from unlawful activity
- ◆ Receive, possess, use, or deal with proceeds of crime
- ◆ Enter into any agreement or arrangement involving proceeds of crime
- ◆ Assist another person to benefit from proceeds of crime
- ◆ Attempt to conceal or disguise the source, nature, or location of proceeds of crime

The practical implications for entrepreneurs: never accept payment from unknown sources; report suspicious transactions to your bank; maintain complete records of all business transactions; ensure all business income is declared to SARS. The penalties for POCA violations include substantial fines and imprisonment.

4.7 Negotiating Finance Terms — Getting the Best Deal

The terms offered by a lender or investor in their initial proposal are rarely the best available. Entrepreneurs who understand the market for capital and negotiate confidently consistently secure better terms than those who accept the first offer:

Interest rate negotiation: The interest rate offered depends on: the perceived risk of the borrower and business, the quality of collateral, the entrepreneur's credit record, the loan term, and the bank's internal risk appetite. Strategies to achieve a lower rate: offer better collateral; increase the own contribution; provide a stronger business plan with conservative assumptions; demonstrate existing banking relationship value (other products held); get competing quotes from other lenders.

Loan term negotiation: A longer loan term reduces monthly repayments but increases total interest paid. A shorter term reduces total interest cost but increases monthly cash flow burden. The optimal term matches the useful life of the asset being financed — equipment with a 5-year life should be financed over 5 years or less.

Fee negotiation: Banks charge initiation fees, service fees, and sometimes early settlement penalties. Initiation fees (typically 1-3% of the loan amount) are negotiable, particularly for larger loans. Ask for fee waivers as part of the overall package, particularly if you are consolidating banking to the same institution.

Suretyship terms: Banks typically require all directors and major shareholders to sign unlimited personal suretyship (meaning they are personally liable for the full loan amount, not just their proportional share). Negotiate to: limit the suretyship to your proportional shareholding; include a release provision when the loan balance falls below a threshold; exclude specific personal assets from suretyship.

Covenant negotiation: Loan agreements typically include covenants — financial ratios the business must maintain (current ratio above 1.5:1, debt-to-equity below 2:1). Breach of a covenant technically allows the lender to demand immediate repayment. Negotiate covenants that are achievable based on your financial projections, not a theoretical ideal.

4.8 Building Long-Term Banking Relationships

The entrepreneur who treats their bank as a transactional service provider will always struggle to access capital. The entrepreneur who builds a genuine, long-term relationship with their banker — sharing business updates proactively, maintaining accurate and complete financial records, being transparent about challenges before they become crises, and demonstrating reliable financial management — will find credit progressively more accessible and more affordable as the relationship develops.

Practices that build a strong banking relationship:

- ◆ Provide regular (at minimum quarterly) business financial updates to your relationship manager — before they ask
- ◆ Maintain accurate, current accounting records and have them professionally reviewed or audited
- ◆ Never allow your account to go into unplanned overdraft without prior discussion with the bank
- ◆ Alert the bank early if you anticipate difficulty meeting a payment — proactive communication protects the relationship; silence destroys it
- ◆ Consolidate your banking relationships — holding all accounts at one bank gives you leverage and simplifies administration
- ◆ Meet your commitments precisely and on time — every payment on time builds credit history; every missed payment damages it
- ◆ Use the bank's other products (business accounts, trade finance, payroll services) to build relationship value
- ◆ Introduce the bank to your suppliers and customers — reciprocal business relationships create mutual dependency

4.9 Preparing for Investor Due Diligence

When an investor or lender is seriously considering your funding application, they will conduct due diligence — a rigorous verification of every material claim in your business plan. Preparation for due diligence begins before the funding conversation starts:

Financial Due Diligence: Audited or management accounts; tax compliance certificates from SARS; bank reconciliations; asset register; creditor and debtor age analyses; proof of all revenue claimed in projections; explanation and support for every projection assumption.

Legal Due Diligence: Company registration documents (CIPC); shareholders' agreements; all contracts (customer, supplier, employment); IP ownership evidence; regulatory licences and compliance certificates; proof of no legal disputes or pending litigation.

Commercial Due Diligence: Evidence supporting market size claims (research reports, industry data); customer references or testimonials; supplier agreements confirming pricing and availability; competitive analysis evidence.

Management Due Diligence: Reference checks on founders and key managers; verification of qualifications and experience claims; psychometric assessments (for larger investments); personal credit checks on all directors.

Technical Due Diligence: For technology or manufacturing businesses: independent technical review of the product, production process, or technology platform.

The entrepreneur who has nothing to hide should welcome due diligence — it is the process that converts a promising pitch into a committed investment. Organise your documents in a virtual data room (a secure online folder) before beginning investor conversations. Being able to provide any requested document within 24 hours signals professionalism and accelerates the process.

4.10 The Optimal Capital Structure Decision

The capital structure decision — how much debt versus equity — is among the most important strategic choices a new venture makes. It affects the cost of capital, the financial risk of the business, the entrepreneur's control, and the long-term growth trajectory. The following principles guide the capital structure decision:

Match funding term to asset life: Long-term assets (property, equipment with 10-year life) should be funded with long-term capital. Short-term assets (stock, debtors) should be funded with short-term capital. Funding long-term assets with short-term debt creates a structural liquidity risk — the debt matures before the asset generates its full return.

Preserve financial flexibility: Avoid using all available debt capacity in the initial capital structure. Retain the ability to raise additional debt if the business grows faster than projected or if an acquisition opportunity arises. A business that has used all its debt capacity cannot respond to opportunities or unexpected challenges without raising equity (expensive and dilutive) or failing.

Manage the debt service coverage ratio: The debt service coverage ratio (DSCR) = Operating Cash Flow ÷ Total Debt Service (principal + interest). Lenders typically require a minimum DSCR of 1.25:1 — meaning operating cash flow covers debt repayments 1.25 times. Design the capital structure so that projected cash flows meet this threshold even under conservative scenarios.

Consider tax efficiency: Interest on business debt is tax-deductible, reducing the after-tax cost of debt. In South Africa, at a corporate tax rate of 27%, a 15% nominal interest rate has an after-tax cost of 15% × (1 – 0.27) = 10.95%. This tax benefit makes debt cheaper than it appears and is a genuine advantage of moderate debt use.

Protect personal assets: When possible, structure the business to minimise the exposure of personal assets to business liabilities. Operating through a properly capitalised private company (Pty Ltd) provides limited liability protection. Avoid unlimited personal suretyship where possible — negotiate limited or proportional suretyship instead.

Chapter Summary

❖ Raising capital follows six steps: determine exact requirements, identify suitable sources, prepare the business plan, present professionally, address concerns, and negotiate to close.

❖ Capital requirements fall into three categories: pre-start-up costs (incurred before opening), initial operational capital (fixed assets plus working capital), and personal living expense provision.

❖ Fixed asset requirements can be estimated by direct identification (specifying every asset needed) or the percentage-of-sales method (applying industry asset-to-sales ratios to projected revenue).

❖ Pre-operating costs include registration fees, professional fees, premises set-up, marketing launch, regulatory licences, staff recruitment, and initial inventory.

❖ The cash flow statement is the most important financial document for a new venture. Cash flow differs from profit due to timing differences, capital expenditures, loan repayments, stock movements, and VAT timing.

❖ Five key financial ratios assess viability: working capital, current ratio, quick ratio, debt-to-equity ratio, and receivables turnover.

❖ Break-even analysis (Fixed Costs ÷ Contribution Margin per Unit) is required by every investor. It shows when the business becomes profitable and demonstrates financial literacy.

❖ Debt financing: borrowed capital repaid with interest. No dilution of ownership. Must be repaid regardless of performance. Typically requires collateral and credit history.

❖ Equity financing: capital in exchange for ownership. No repayment obligation. Investors share upside and risk. Results in ownership dilution and shared decision-making.

❖ Venture capital and angel investment provide equity for high-growth businesses. Angels invest R200k-R5m with hands-on mentorship; VCs invest larger amounts for high-growth opportunities.

❖ Alternative funding sources: personal savings, family and friends (must be formalised), credit cards (for small short-term needs), government grants (SEFA, IDC, NEF, NYDA, Khula), leasing, hire purchase, and franchising.

❖ Leasing preserves capital and provides flexibility; hire purchase transfers ownership at the end of the payment period. Leasing is more expensive over time but conserves cash.

❖ South African funding institutions include SEFA, IDC, NEF, Land Bank, NYDA, Khula, commercial banks (Big Four), Business Partners, and SEDA.

❖ Debt financing challenges: no trading history, insufficient collateral, uncertainty premium, entangled position, personal suretyship requirements.

❖ Equity financing challenges: equity gap in the R500k-R5m range, lack of investor networks, market trust deficit, exit route limitations, governance requirements.

❖ The personal income and expenditure statement shows surplus income available to service new debt obligations. Banks require this when assessing personal suretyship and the entrepreneur's financial health.

❖ The personal assets and liabilities statement calculates net worth (Assets minus Liabilities). It identifies potential collateral and demonstrates the entrepreneur's overall financial position.

- ❖ Bank loan applications require: business plan, cash flow projections (36 months), capital expenditure budget, personal balance sheet, CVs, shareholder contributions, FICA documents, bank statements, lease agreement, and supporting customer contracts.
- ❖ Banks assess applications across six dimensions: who you are, why the business is viable, exactly how much is needed, your own contribution, available collateral, and repayment sources.
- ❖ FICA (38 of 2001) requires identity and address verification for all financial service clients. POCA (121 of 1998) criminalises receipt, possession, or use of proceeds from unlawful activities — including money laundering.

Application Exercise: Prepare a complete capital requirements plan for your own venture: (1) List all pre-start-up costs with actual quotes. (2) List all fixed assets required with purchase or lease decisions. (3) Project monthly operating costs for the first 12 months. (4) Build a 12-month cash flow projection. (5) Calculate the break-even point. (6) Identify the most appropriate funding sources for each component of your capital requirement. (7) Compile your personal income and expenditure statement and your personal assets and liabilities statement. This exercise produces the financial foundation of your business plan.