**Equity** 

Equity is what the owner has **PERSONALLY** invested into their business**.** This represents their personal **FINANCING** of the business.

The type of **ownership structure** will determine what this equity is called.

|  |  |  |
| --- | --- | --- |
| **Ownership structure** | **Description** | **Type of equity** |
| Sole trader | One owner; usually a small business | Capital |
| Partnership | Two or more owners | Capital |
| Company | One or more owners (shareholders). Can be as small as the corner dairy or as big as Microsoft Corporation (Revenue $85 billion). Companies have to be formed and registered through the Companies Office. It is a legal requirement to follow this process when forming a company. | Contributed equity / share capital |
| Trust |  A trust is a legally binding arrangement when a person (the settlor) transfers legal ownership of assets to certain chosen persons (trustees) to be held on trust for the benefit of persons named by the settlor (the beneficiaries). Once a trust is created, the settler loses legal ownership of the assets in question. However, the settlor may be a beneficiary and even a trustee too. This would assist the settlor to retain some form of control over the trust. | Accumulated fund |
| Co-operative | A co-operative is a term used to describe a business organisation that is owned and democratically controlled by its members. E.g. co-operative taxi services, milk supply etc<https://www.companiesoffice.govt.nz/companies/learn-about/other-registers/co-operative-organisations#examples> | Share capital |

**Starting a business.**

To start a business requires an investment by the owner. This investment will involve a significant amount of cash. The cash invested will often represent the owner’s life savings. This cash will be used to purchase assets of the new business e.g. a fishing boat if setting up as a commercial fisherman. The owner may also invest other assets such as vehicles, buildings, land, equipment, computers etc when starting their business. 

Equity is different from loans, mortgages, debentures, bank overdraft etc. This type of financing is referred to as **DEBT finance** and it is sourced from **EXTERNAL** sources e.g. banks and finance companies. To start the business the owner may also require debt finance to buy assets.

A successful business will be profitable. The owner will receive a share of the profit in the form of drawings (sole traders and partnerships) and dividends (companies and co-operatives). Any profit kept in the business (not shared out to the owners as drawings or dividend) will grow the equity in it. This equity can be used for expansion when the time is right.

**Additional Equity**

Strategic capital expenditure will require financing and there are a number of financing options. These options include:

* Equity only
* Debt only
* Mixture of debt and equity

**Equity Only**

To finance the strategic capital expenditure additional equity can be raised. How this will be done will often depend on the ownership structure and size of the business.

**Sole traders**

* Raising additional equity finance will require the owner to put/ invest more of their personal money into the business. They can also **draw out less of the profit** each year which will help retain / build equity in the business. Some of this equity will be cash.
* They could also look at changing the ownership structure by looking at forming a partnership with a new investor in the business OR changing to a company structure if they have investors who would be prepared to buy shares in the company.

Advantages

* No additional debt and therefore no interest or loan repayments which reduces pressure on cash flow
* A partner may bring new skills and access to a wider client base

Disadvantages

* The amount of equity that can be accessed may not be large
* Loss of some control of the business if you have partners or shareholders
* Waiting for equity to build up in the business can take too long and opportunities are missed

**Partnerships**

Partnerships access to additional finance is similar to sole traders so I won’t spend time on this ownership structure.

**Companies**



The access to additional equity for a company will really depend on the size of the company.

**Smaller companies**

The corner dairy down the road could have been formed as a company but it’s access to additional equity will be similar to that of a sole trader. Limited in amount and also reliant on retaining / building profit in the company. Additional shareholders are likely to be family members.



**Bigger companies**

Bigger companies have access to larger amounts of equity. Some of these companies such as Gallagher are referred to as **private** companies as they are not listed on the NZ Sharemarket <http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10803467>

They can issue more shares to raise finance but it is not as easy as it is for companies listed on the NZ Sharemarket. They can use a share broker as brokers deal with private equity issues. The share brokers will have clients that are looking to invest in different types of companies and a private company may be the investment they are looking for.



Other large companies are listed on the NZ Sharemarket and have access to investors throughout NZ and the world. To raise additional equity they can issue new shares to the public. This will usually be through a sharebroker. Anybody that wants to buy shares in companies listed on the sharemarket will require a share broker or a financial advisor and they will require a brokerage account. This kind of share issue has the ability to raise tens or hundreds of millions of equity because of the amount of potential investors available to them.

Advantages

* Bigger companies can raise large sums of equity
* Access to more potential investors
* Not required to pay back what is invested, apart from future profits in the form of dividends

Disadvantages

* Existing **shareholdings** can be diluted with new shares if they are not issued pro rata. This means a smaller percentage of the profit will be received by existing shareholders
* Can lose control of the company as there are more owners involved in decision making

Gallagher <http://www.interest.co.nz/business/63427/andrew-patterson-talks-energetic-chief-gallagher-group-worlds-leading-manufacturer>

Tru test <http://www.interest.co.nz/rural-news/63045/tru-tests-biggest-shareholder-and-rival-gallagher-group-says-no-renounceable-rights>

<http://www.stuff.co.nz/business/farming/agribusiness/84399369/synlait-reveals-98m-offer-for-expansion-plans>

<http://www.stuff.co.nz/business/money/9313216/Choosing-the-right-sharebroker>