Don't Expect a Large Return on a Small Equity

Many businesses are undercapitalized, meaning the owners have not invested enough money so they must rely on external lenders.

This situation can develop over time as the owners withdraw excessive amounts of cash; others may have been undercapitalized from the start.

It is even possible for the owners to have a 'negative' investment whereby they actually owe money to the business.

By way of an example, compare these three businesses:

* Each has the same investment in assets but different levels of **funding:**

Business Assets	**A**	**B**	**C**
Net Working Capital	286,945	286,945	286,945
Other assets	151,992	151,992	151,992
Total Assets	**438,937**	**438,937**	**438,937**
Funding of Assets			
External debt	20,474	185,867	345,033
Other liabilities	8,302	8,302	8,302
Owner's equity/investment/wealth	410,161	244,768	85,602
Total Funding	**438,937**	**438,937**	**438,937**

What do these numbers suggest?

Business A: *Is financially strong with **95%** equity and only **5%** debt*

Business B: *Could be heading for trouble with **44%** debt and **56%** equity*

Business C: *Is in a desperate situation with only **20%** equity funding.*

There are three main ways a Business C situation can develop:

1. Insufficient cash was invested by the owner to start the business
2. Business profits have been consistently too low to build up equity
3. The owner has been withdrawing equity faster than it is replenished.

Finally, think about this:

Too many business owners expect a **LARGE** return on a **SMALL** investment. If it were possible, everyone would succeed at doing it!