How financing is important for the success of the company

Business

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Business Introduction To run a business a company needs money. The act of arranging money for the business is termed as Financing. A company can avail mainly two sources of finance for its business. One is debt and other is equity. The report discusses how financing is important for the success of NIKE.

Discussion

Nike is a multinational company with a big business venture spread over several countries. To run such a huge company efficiently Nike needs finances. Nike needs finances not only for financing its current operations but any new venture that Nike will try to enter into will also require money and therefore financing. Sourcing finance is one of the critical factors determining the success or failure of a company. For example in 1971 Phil Knight was faced with a crunch situation regarding his company Nike. The company had at that point of time owned several stores and sales turnover was nearly $300, 000. The company was poised for expansion. But the problem the Knight faced was that the company needed capital to finance the growth and this capital was not available with Knight at the point of time. It got this much required finance from Nissho Iwai Corporation, a Japan based trading company. Through this finance the company could start manufacturing its own line of products outside its home country and then bring the finished goods back to USA in order to market those. Any firm has access to mainly three sources of finances Debt, Equity and Retained earnings. Different sources of finance have different associated costs. The cost of debt is calculated as coupon rate (1-tax rate). Cost of equity on the other hand is calculated as = (Dividend per share/ Market price of share

(MPS)) + growth rate of dividends. Normally debt capital is considered as a cheaper source of capital than equity capital. However both Debt and Equity comes with associated advantages and disadvantages. Normally the firm should go in for a balance of debt and equity financing. The total debt capital used by Nike is $2, 743, 000 whereas total equity capital of the firm is $10, 824, 000. The viability of a financing option depends primarily on the issue of whether the return of the investment proposal is greater the cost of the particular source of finance. For example in 2002 Nike decided to enter into a contract with university of Alabama whereby it agreed to pay them $100, 000 annually (Kish, 2013). Whereas this deal may sound as too expensive but such deals are pretty important for sports giants like Nike. They require going in for such deals in order to stay competitive, boost sales, and stay in the minds of customers. Financing plays an important role in justifying the reason behind a company going in for such deals. To analyze the viability of such deals the company needs to predict future incomes to be generated from such an investment venture. Then discount the projected future earnings to today’s valuation levels in order to compute for the IRR. When analyzing the source of finance the company should use to finance such ventures the company should ensure that the cost of capital is less than that of the internal rate of return.

Conclusions

Financing is important for any company in this world. A company while analyzing a business opportunity should analyze it on the basis of rate of return and compare it to the cost of capital. The company should go in for the business opportunity if and only if the cost of capital is less than rate of return. Nike has followed this for long and this is why it has been successful.

References

Kish, M. (2013). Nike, Adidas spend big to ‘ own the campus’. Retrieved from: http://www. bizjournals. com/portland/print-edition/2013/08/30/nike-adidas-spend-big-to-own-the. html? page= all