Proceedings of the 7th International Conference on Economic Management and Green Development
DOI: 10.54254/2754-1169/44/20232225

Research on Risk Management under Enterprise Financing

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Abstract: Financing is an indispensable process for the development and growth of enterprises, and there are various ways of financing enterprises. However, enterprise financing is accompanied by various risks, and enterprise risk management is a key factor in ensuring the continued operation of enterprises and enhancing their competitiveness. How to cope with these risks is crucial to the healthy development of enterprise financing and operations. Therefore, this paper discusses risk management under enterprise financing through theoretical analysis and a case study. Through the analysis, financing risks mainly include cash flow crises, capital structure changes, dilution of shareholders' equity, conflicts of interest, etc. In order to cope with the risks arising from financing, enterprises can usually take measures such as disclosing information and evaluating risks regularly, optimizing capital structure, and coordinating creditor-debt relationships. In addition, enterprises can ensure that their claimed technologies and products are in line with reality and ethical and legal requirements by establishing transparent technology verification and auditing mechanisms.

Keywords: enterprise financing, financing risk, risk management, risk analysis

1. Introduction

Enterprises in production and sales, regardless of any link, cannot lack financial support. Therefore, ensuring a smooth source of funds is a necessary condition to maintain the normal operation of enterprises [1]. Therefore, enterprises need financing in the process of pursuing development and growth, but certain risks also accompany financing activities. Financing risk is a common risk faced by enterprises in the process of daily operation and management, which specifically refers to the risk events caused by many uncertain factors in the process of financing [2]. Corporate risk management is a key factor in ensuring sustainable operations and enhancing the competitiveness of enterprises. The effective implementation of reasonable corporate risk management policies can reduce the negative impact of financing activities on enterprises and improve the stability and return rate of enterprises. The method adopted in this paper is literature analysis. This paper will list four common forms of enterprise financing, analyze their risks one by one, and put forward reasonable risk prevention measures. The purpose of this thesis is to study the strategies and methods of corporate risk management under corporate financing, in order to provide practical and decision-making guidance.

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2. Enterprise Financing

Corporate financing mainly includes four financing methods: debt financing, equity financing, mixed financing, and risk financing [3]. However, different financing methods also have their risks and precautions.

2.1. Debt Financing

Debt financing refers to the raising of working capital or capital expenditures by selling bonds or notes to individual or institutional investors. An individual or institutional investor lends money, becomes a creditor of a company, and receives a commitment from the company to repay its capital and interest.

2.1.1. Risks

First of all, enterprises may encounter interest rate risk in debt financing. Changes in interest rates may have an impact on a company's financial position and solvency. For example, a rise in interest rates will increase the company’s interest expenses, leading to a subsequent increase in pressure on the corporation to repay debts. Secondly, companies will face risks to their solvency. Debt financing involves the solvency of the enterprise, and if the enterprise is unable to repay its debt on time, it may lead to an increased risk of default, which will affect the enterprise's ability to repay its debts. In addition, liquidity risk may also occur in debt financing, which may increase the debt burden of enterprises and lead to insufficient liquidity. A company that is unable to repay its debts on time will face a liquidity crisis, which will further affect daily business activities [4].

2.1.2. Measures

Enterprises should conduct appropriate and adequate risk assessment and avoidance before debt financing. The evaluation includes the assessment of interest rate changes, solvency, liquidity, and other risks, and formulates corresponding avoidance strategies based on the evaluation results to avoid additional interest expenses. Moroerver, enterprises should pay attention to the cost accounting of the use of funds, support the integration of different data, and give full play to the function of risk prediction [5]. In addition, an effective risk monitoring and control mechanism can be established in the company to regularly monitor factors, such as debt repayment status and interest rate changes.

Finally, enterprises should implement flexible financial management. Zhao proposes to complete the construction of the fund flow risk early warning system from the perspective of fund flow. The analysis can be completed in the form of model construction to judge the current situation of enterprises. According to the current situation, corresponding measures should be taken in time to complete risk control, thereby reducing risk and losses [6]. Moreover, enterprises can improve their solvency and liquidity through flexible financial management, including reasonable capital planning, cash flow management, and budget control, and reduce debt financing risks.

2.2. Equity Financing

Equity financing refers to the financing method in which the shareholders of the enterprise are willing to give up part of the ownership of the enterprise, introduce new shareholders through enterprise capital increases, and increase the total share capital. With the funds obtained by equity financing, the enterprise does not need to repay the principal and interest, but the new shareholders will share the profits and growth of the enterprise with the old shareholders. Equity crowdfunding, a product of the development of Internet finance, has the advantages of convenience, speed, and flexibility, which can well realize the docking of private capital and small and micro start-ups, and thus effectively sharing the financing pressure of the financial market [7].

2.2.1. Risks

When an enterprise conducts equity financing, it may face the risk of equity dilution, that is, equity financing will introduce new shareholders, resulting in dilution of the equity proportion of existing shareholders.

In addition, equity financing involves equity allocation, which may lead to the risk of shareholder conflict. After equity financing, there may be conflicts of interest and differences of opinion between different shareholders, which may lead to problems in corporate governance and decision-making difficulties.

Equity financing may lead to the transfer of the right of control, Investors will inevitably own more equity after several equity financing rounds, even exceeding the shareholding of the founding team or individuals. The original shareholders may lose the control of the company, and the decision-making ability of the enterprise's operation and development direction is limited. This will eventually lead to too much decentralized control of the enterprise, which will affect the daily decision-making and operation of the enterprise [8].

2.2.2. Measures

Before financing, the enterprise should formulate a shareholder cooperation agreement to clarify the rights and obligations of each shareholder, and stipulate the decision-making mechanism and power distribution, so as to reduce the risk of shareholder conflicts.

It is also important to establish a good credit mechanism. Enterprises should regularly communicate and disclose information, and strengthen communication and information disclosure between shareholders, so as to provide shareholders with adequate, accurate and timely information and reduce the risk of information asymmetry[9].

When enterprises adopt stock financing, they should deeply and comprehensively analyze the influence of stock ownership status on the daily operation and management of enterprises, so as to ensure that financing will not have excessive volatility influence on the power distribution of enterprise operation and management [10].

2.3. Hybrid Financing

Mixed financing refers to a special financing method with dual characteristics of equity financing and debt investment. For issuers, the financing cost of hybrid financing is generally lower than that of equity financing, and it will not affect the control of the shareholder. For investors, hybrid financing generally sets exit or redemption terms in the issuance documents while guaranteeing returns, and the investment risk is less than that of ordinary equity investment. Therefore, Hybrid financing is more suitable for small and medium-sized enterprises. To avoid excessive debt repayment pressure during the expansion of smes, equity, equity-like and mixed financing methods should be promoted simultaneously while expanding debt financing channels such as bank credit [11].

2.3.1. Risk

Mixed financing may lead to changes in the capital structure of the enterprise, which in turn threatens the capital structure and increases the financial risk. Moreover, too much debt financing may increase the pressure of debt repayment, while too much equity financing may lead to dilution of shareholders' equity, and ultimately cause the imbalance of capital structure.

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Secondly, hybrid financing can often create conflicts of interest between equity and debt. Hybrid financing involves different types of investors, with shareholders pursuing corporate growth and rising share prices, while creditors focus on debt repayment and stable cash flow. As a result, there may be conflicts of interest between shareholders and creditors.

In addition, mixed financing may involve different tax policies and tax rates, requiring enterprises to reasonably plan their tax structure to minimize tax risks and burdens.

2.3.2. Measures

In the process of mixed financing, enterprises need to comprehensively consider the ratio of debt and equity, optimize the capital structure according to the characteristics and needs of enterprises, balance financial risks and shareholders' equity, and avoid additional property losses.

In addition, coordination between shareholders and creditors is important. Enterprises need to establish a good relationship between shareholders and creditors, fully communicate and negotiate, understand and respect each other's rights and interests, and solve potential conflicts of interest through cooperation.

Finally, enterprises should establish an effective risk management and control mechanism, including regular monitoring and assessment of the financial status and risk status of enterprises, and timely measures to manage and control risks.

2.4. Risk Financing

Risk financing is a form of equity investment in which an investor injects money into a start-up or high-growth potential business in exchange for equity or options and assumes investment risk. Risk financing has a long term, does not increase the debt burden of enterprises, and is very suitable for small and medium-sized enterprises with tight funds to finance technological innovation.

2.4.1. Risks

When choosing a partner, entrepreneurs should consider not only the cash input of investors, but also the non-monetary resources of investors. These non-monetary resources mainly include investors' reputation, investors' network relationships and investors' past performance [12]. Therefore, in venture financing, start-ups or companies with high growth potential face high survival risks, fierce market competition, and products or services may face uncertainties such as market acceptance and technical feasibility.

Secondly, if the enterprise undertakes risk financing, it may face the risk of capital return. Moreover, venture financing usually requires an exit within a certain period of time in order to earn a return on investment. However, companies may not be able to successfully achieve an exit, resulting in limited returns on investment.

In addition, venture capital usually involves technological innovation and market prospects, some venture financing projects may rely on new technologies or innovative solutions, and the risk of technical feasibility and technological innovation may affect the successful implementation of the project. Venture financing projects may also face market risks, including uncertainties of market size, market acceptance, market competition and other factors.

2.4.2. Measures

Venture financiers should conduct adequate due diligence to assess factors such as the commercial feasibility, technical feasibility and market prospects of the project to reduce the risk of investment.

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In addition, risk diversification is conducive to reducing the uncertainty of risk financing. Investors can diversify their portfolios and invest their money in multiple projects or businesses, reducing the impact of the risks of individual projects or businesses on the overall investment return.

Enterprises should carefully evaluate the leverage level of enterprises based on their own solvency, expand financing channels and reduce capital costs on the basis of reasonable expectation of future cash flow demand [13]. We should actively introduce strategic investors to the outside world, strive to curb the tendency of single financing channels, and reduce the capital risk of enterprises.

3. Case Study

Theranos Inc. is an American biomedical company that claimed to be able to perform a number of blood tests from tiny amounts of blood. During the fundraising process, it was valued at as much as $9 billion with this technology. However, it was revealed that it had serious technical and ethical problems, and eventually faced bankruptcy and legal action.

3.1. Reason for Funding Failed

The company has technical infeasibility and fraud. Theranos Inc. claimed to have revolutionary blood testing technology, but in fact the technology failed to live up to its claims of accuracy and reliability. The company is also suspected of false publicity and falsified data to mislead investors and partners.

In addition, the company lacks independent auditing and oversight. Theranos Inc. was not reviewed by independent auditors in its fundraising process and was not subject to adequate regulatory oversight. This led to investors' ignorance of the company's real situation and regulators' failure to detect the company's violations.

High valuation is also the reason for its financing failure. Theranos Inc. received an extremely high valuation in the financing process, but those valuations were based on false claims and false data. Investors' blind pursuit and lack of adequate due diligence led to heavy losses for investors.

Theranos lacked transparency in the financing process and failed to provide sufficient information and data support. Investors lack a clear understanding of the company’s business model, technical details and risks, resulting in inaccurate investment decisions.

3.2. Suggestions

Companies should establish transparent technology verification and audit mechanisms to ensure that claimed technologies and products are realistic and comply with ethical and legal requirements.

Additionally, enterprises also should strengthen independent auditing and supervision to ensure that investors and regulators fully understand the true situation of the company, and promptly detect and correct violations. In the early stage of making investment decisions, enterprises should conduct detailed and comprehensive investigation and research on their investment structure and investment planning, and must be fully prepared for possible market expectations and market changes, so as to further optimize their investment structure and achieve expected investment returns.

Furthermore, investors should be more cautious to conduct adequate due diligence on the company they invest in, and independently verify the company's technical and financial data, so as to avoid over-chasing hot and highly valued companies.

As a result of this corporate funding failure, other companies can be vigilant about similar issues, enhance due diligence, independent audit and regulation, improve transparency and communication, ensure technical feasibility and ethical compliance, and thus improve the chances of successful financing.

4. Conclusion

Many financing problems may depend on the economic conditions of the overall market. In the process of enterprise financing, there are various potential risks, including debt financing, equity financing, mixed financing and risk financing. These risks may involve business models, technical feasibility, market prospects, return on capital and many other aspects. In order to reduce the risk and increase the chance of financing success, enterprises can take a series of solutions.

This paper only analyzes the risk of four common financing methods, and does not conduct in-depth analysis of other financing methods. In the future, we can analyze the combination of other financing methods and compare their risks and measures to improve the article.

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