Q: How can my firm increase the amount of capital held?

To understand how a firm can increase the amount of capital (also referred to as “Own Funds”) that it holds we should first look at what Own Funds comprise.

The composition of the Own Funds can get quite complicated, as well as include certain deductions, however, the majority of firms will only need to consider Tier 1 capital (and potentially some deductions, such as losses for the current financial year). This is illustrated in the below extract from the FCA’s Approach Document:

CET1 (Common Equity Tier 1) Items
[CRR 26, 27, 28, 29 & 30]

(a) Capital instruments (e.g. ordinary shares)
(b) Share premium accounts
(c) Retained earnings
(d) Accumulated other comprehensive income
(e) Other reserves

The level of Own Funds held is therefore mostly affected by the amount of share capital that has been issued (Ordinary Share Capital + Share Premium) and the trading activities, i.e. profits and losses, of the business (Retained earnings and Other reserves).

The two obvious ways to increase the capital held by the business would be to:

1. **Issue additional Ordinary Shares** – issuing new Ordinary Shares will increase the Share Capital and Share Premium accounts, per (a) and (b) above. New share capital would be issued to existing or new investors in exchange for (in most cases) an investment of funds. The investment of funds into the business provides working capital to finance ongoing development as well as supporting the capital position. Additional investments in a business are often required to support expansion or where the business is loss making and cannot increase cash resources or capital by generating profits; and

2. **Generate profits** – profits that are made during the year are moved to the Retained earnings (or P&L Reserve), see (c) above, as part of the accounting processes. Retained profits serve to increase the Own Funds held (whereas losses reduce it). For start-up businesses there is a balance between being able to generate profits and having to seek investment (per above). Reaching a state of profitability can take considerable time and inward investments may be the only real option to support capital and cash flow requirements. Note also that a business may be growing at a significant rate, with consequent increasing capital requirements, but also be loss making. This divergence will almost certainly need to be funded by additional investments in share capital.

The requirement to deduct interim (unaudited) losses and the inability to add interim profits can also be an unanticipated hurdle in meeting the Own Funds requirement. It is advisable for firms to track (via their management accounts) and forecast (in their financial forecast / budgets) the Own Funds held and the Own Funds required in order to ensure that requirements are met on an ongoing month by month basis.