ANY QUESTION?

Sources of Finance

Chapter 25 & 26
SdP

Learning objectives

Choosing sources of finance

What are sources of Finance?

Sources of finance are methods by which businesses can gain money, either directly or indirectly

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Learning objectives

What are sources

Why do firms need finance?

Different typs of finance: internal and external.

Short-term sources vs Long-term sources of finance

What are sources of Finance?

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Sources of finance are methods by which businesses can gain money, either directly or indirectly

Why do businesses need finance?

New firms need the finance in order to purchase **START-UP** assets. Some of this resources are "one-off" items.

To meet the day-to-day running costs of the business. This expenditure is called **WORKING CAPITAL**.

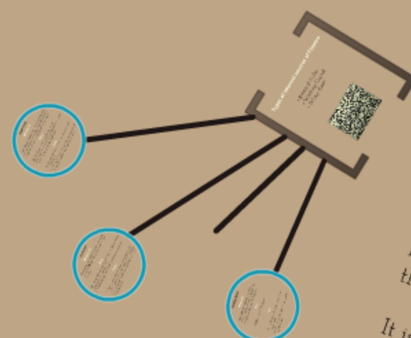
When the business is estabilished the owners often want to **EXPAND**: growing orders, develop new products, overseas market, diversify.

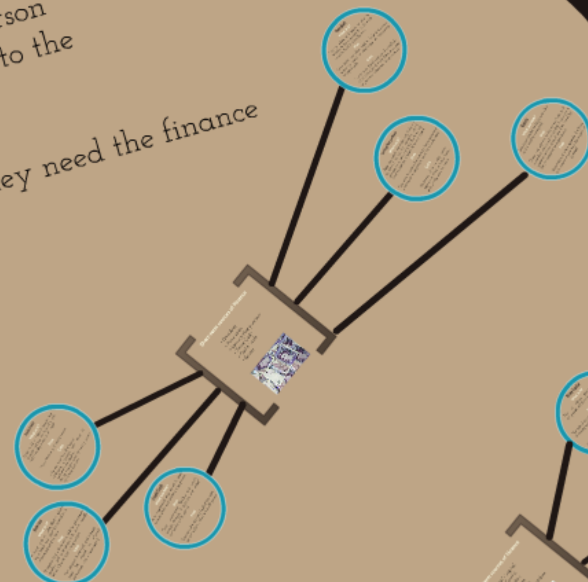
EMERGENCY FUNDING: Business can get unexpected bills and are often forced to raise money quickly when cash runs short.

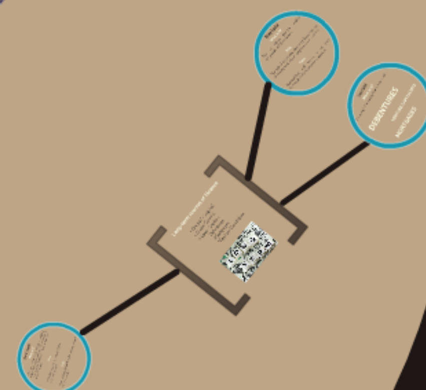
Types of Sources of Finance

External: Funds obtained from a person or organisation with no connection to the business.

Businesses have to justify why they need the finance







Internal: Funds from within the business, and can only be used when the business is estabilished.

It is a quick and easy way to solve short term money problems.

It saves borrowing money and having to pay back interest- making it useful

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Types of Internal sources of Finance

- Retained Profits
- Working Capital
- Selling Assets

Retained Profits

What is it?

These are profits that the owners have decided to reinvest back into their business. It is the most important source of finance because it is cheap.

Pros

- It doesn't have to be re-paid with interest
- Less need for investors for growth, therefore more control in decision-making processes

Cons

- Profits may be low, so only low amounts could be reinvested
- Investors may also be unhappy at the lack of dividends to enable the company to grow

Working Capital

What is it?

- Reducing the trade credit period;
- Reducing the amount of stocks held;
- Delaying payments to suppliers.

Pros

- Nothing has to be re-paid

Cons

- It could only be used as a short-term source
- Only a limited amount of money could be used

Sale of Assets

What is it?

A company can sell machinery or premises or even different sectors in order to raise finance.

Pros

- It reduces costs as maintenance for unused equipment does not have to be paid for
- It makes money out of useless parts to your business

Cons

- There is a limit to how many assets can be sold before the business would start to fail to function
- The equipment might be needed at a later time
- Unsustainable

Short-term sources of Finance

- Overdraft
- Bank Loan
- Leasing/Hire purchase
- Trade Credit
- Credit Cards
- Grants

Overdraft

What is it?

This is when a business is able to withdraw more money from its bank account than it actually has.

Pros

Overdrafts are often used to help a business when in need of short-term or temporary storage funds.

Cons

There is no fixed amount of overdraft, as it varies on a daily basis a money is paid into/taken out of the account prob

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Bank Loan

What is it?

A bank loan is debt, that is given by a bank and must be repaid in a certain amount of time

Pros

It means that a business is able to get money quickly and a business will know exactly what it has to pay every month.

Cons

The amount borrowed and interest, must be repaid in regular instalments over a fixed period.

Leasing/Hire purchase

What is it?

When payments are made regularly for equipment (a car, for example). Leased equipment is not owned by the firm, but hired equipment is when all money is paid.

Pros

This saves businesses from making large immediate investments, as payments are made in instalments.

Cons

However, it is usually more expensive than a bank loan, and is only used on assets.

Trade Credit

What is it?

Trade credit is when businesses buy resources and pay for them at a later date. (usually within 30-90 days)

Pros

It is a cheap way of raising finance.

Cons

- The cost of goods is often higher;
- Delaying paymenst may result in problems with suppliers;
- Many suppliers encourage early payment by offering discounts.

given

Credit Cards

What are they?

It is a payment card issued to users (cardholders) as a method of payment

Pros

They convenient, flexible and avoid interest charges. if accounts are settled within the credit period.

Cons

Interest rates are very high if accounts are not settled within the credit period.

Grants

What are they?

Grants are similar to bank loans, but do not need to be repaid.

Pros

There is no interest, as the money lasts as it is needed, and is not repayable. It also gets a business known, as they are often given by the government or corporations.

Cons

Once again it is the opposite of a loan, as it can be a long time for a grant is granted.

Long-term sources of Finance

- Owner's Capital
- Share Capital
- Loan Capital:
  - Debenture
  - Mortgages
  - Venture Capitalists

Owner's Capital

What is it?

When the owner or owners of a company invest their own money into the company in order to make it expand. This is a long term source of finance

Pros

- Flexible amount of cash available
- No added costs

Cons

- The costs are incurred at the owners expense
- Unsustainable

Share Capital

What is it?

This is when private limited companies sell their shares.

Pros

The sale of shares can raise very large amount of money and interest payments are avoided.

Cons

Shareholders will expect to be paid dividends if the business is successful.

Loan Capital

What is it?

Loan capital is money that is borrowed.

DEBENTURES

VENTURE CAPITALISTS

MORTGAGES

Government finance

What is it?

In many countries governments give financial help to businesses.

Guarantee scheme

Small businesses and start-ups are favoured

Grant

Lend money at low rates of interest

Give money

Ex.:

Enterprise Finance Guarantee (EFG)

Working Capital Scheme (WCS)

Enterprise Capital Funds (ECFs)

Choosing sources of finance

HOW TO RAISE FINANCE

Cost

Use of funds

Status and size

Financial situation

Risk

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