A Level Business

Sources of finance

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A Level Business: Sources of Finance

Introduction

Finance and source of that finance is vital to any business at start-up and throughout its existence

Understanding

. Sources of finance – internal and external
. Advantages and disadvantages of the different sources of finance
. Sources of finance may depend upon: amount of money needed
purpose of finance
time period required
legal structure of business
financial situation of the business

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Sources of finance

£ Need for finance

Start-up
. raw materials
. premises + utilities
. wages
. ongoing costs

Operational expenditure
- items used quickly: wages; raw materials; supplies; petrol [illegible]

Capita[illegible] [illegible]endi[illegible]
. items [illegible]ded f[illegible] [illegible]e
[illegible] . premises;
e[illegible]ment; vehicles etc
. u[illegible] in the long term

Internal finance

Finance that the business already has – profi[illegible] from prev[illegible]s ye[illegible]:
Retai[illegible] pro[illegible]

[illegible]fin[illegible]ons

External finance

Finance that comes from outside the business
e.g. a bank loan

£ [illegible]ort [illegible]rm finance (less than a year)

[illegible] b[illegible]. Temporary cash shortages

[illegible]verdraft

Retained profit

Debt factoring

£ Long term finance (more than a year)

. Purchase non current assets . Long term plans

Bank loans/mortgages

Retained profit

Share capital

Venture capital

LO: Understand the different sources of finance – internal and external

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Internal sources of finance

£ Retained profits

+

. Business use profit from current or previous years
. Own profit therefore no loan interest
. Not need to sell shares

–

. Shareholders not always like se profit ther than high vide
. Profits can ge e interest ar

Research a com at un took a sale and leaseback.
Expla e bene o m od of raising cash for the business.

£ Sale of assets

+

. Non current assets – land, buildings etc. that are not needed - can raise a lot of capital
. Own assets therefore no loan interest
. Sell then leaseback

–

. Lose the assets that might be needed in the future
. Leaseback payments is a cost you did not have before

LO: Understand the different sources of finance – internal and external

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External sources of finance

£ Bank overdrafts

Overdraft = short term finance
Banks set a limit than can be borrowed at any time

\+
. Ver xible
. E to arran ange

–
ly designed for short term
Can be very expensive
. Banks can demand repayment at any time

£ enture capital

ndivic s a ar tions provide finance in exchange for
har n the ny & perhaps a seat on the board

\+
. VCs can also provide experience, expertise, contacts etc.

–
. Limited amount that can usually be borrowed
. Have to give up shares in the company

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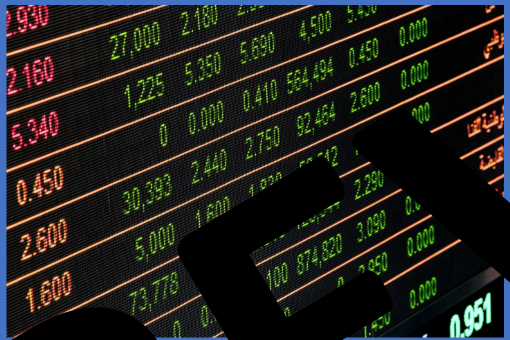
External sources of finance

£ Share or equity capital

Common method for start-ups and established companies
Sell a share of their business to raise capital



\+

. Can [illegible]se large [illegible] of money
. PL[illegible] sell sh[illegible]es (stock exchange)

–

[illegible]suing shares is expensive
. Can be difficult selling shares in private companies
. Can lose control of the company to shareholders

£ B[illegible]an[illegible] mortgages and debentures

Ban[illegible] a c[illegible]mon [illegible] of finance for start-ups and established businesses

[illegible]ans – pa[illegible] over a certain time, higher the risk the higher the interest charge (start-ups)

. L[illegible]ans secured against assets (property) known as collateral

Mortgage is a type of loan – a long term loan: fixed or variable.
Land or property is used as collateral
Can re-mortgage to raise capital

Debentures are a long term loan to be repaid at a certain date. Interest paid is fixed – sometimes debentures have no repayment date. Like a permanent loan.

\+

. Well established way of raising capital
.

–

. Default on the loan and the bank takes the asset
. Can be expensive for start-ups

LO: Understand the different sources of finance – internal and external

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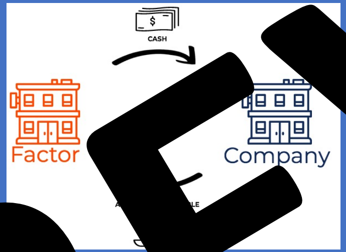
External sources of finance

£ Debt factoring

Function provided by banks & other institutions
Businesses can sell payments (invoices) that are due to them
Business receives 80% immediately and the rest (-5%) when the invoice is paid
Debt factoring is becoming more popu



+ . Im liate c advanc yment (80%)
with c low
Cheap n an overdraft

− . 5% taken eats into profit margin
. Can get a 'bad' reputation for factoring debt

£ owd funding

W of r ney from people who will get
eth in re nce the project/business succeeds

+ . Can be a quick way to raise money
. Investors give feedback
. A way of getting interest

− . Take time to get interest
. Can fail to hit target then have to return money

Peer-to-peer funding

Raising finance through investor loans to businesses
Interest is paid to the investors

+ . Attractive interest rates
. Quick and easy process - online

− . Can be extra fees
. Less protection/flexible than banks

LO: Understand the different sources of finance – internal and external

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Sources of finance - Quiz

Read each statement decide if it is TRUE or FALSE

	Statement	T	F
1	Debt factoring can give businesses quick payment on invoices		
2	Family and friends often provide finance for sole traders		
3	Venture capital is a guaranteed form of finance for all start-ups		
4	Dividend payments can [illegible] hit when companies [illegible] retained profit for [illegible] projects		
5	Private companies are listed on the stock market		
6	Twitter has recently bought by Elon Musk		

	Statement	T	F
7	Crowdfunding is a popular way of raising money for PLCs		
8	Mortgages are used for short term loans		
9	Issues shares is common way of raising finance		
10	An overdraft is a short term finance option		
11	Overdrafts are a cost effective way to borrow money		
12	Sole traders can raise capital on the Stock Exchange		

LO: Understand the different sources of finance – internal and external

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Sources of finance - Quiz

You have the answer but what is the question?

	Answer	Question
1	Collateral	
2	Crowdfunding	
3	Mortgage	
4	Debt factoring	
5	Overdraft	
6	Retained profits	
7	[illegible]ernal finance	
8	Share capital	

LO: Understand the different sources of finance – internal and external

Sources of finance

£ Utopia Board Game

. Mo and Faris have invented a fantasy style board game
. They need about £5,000 to get the game produced and for marketing

W[illegible] fin[illegible]l optio[illegible]e available to Utopia?

Wha[illegible]rce of finance would you recommend [illegible]Utopia? Explain your answer

Sources of finance

£ Clare's Nail Spa

. Clare is an experienced nail technician who has decided to open her own nail spa
. She has invested £10,000 of her own money into the business and needs another £10,000.
. There are other nail spas in town but Clare has a good reputation.

[illegible]t fin[illegible]al optio[illegible]re available to Clare?

Wha[illegible]urce of finance would you recommend [illegible] Clare? Explain your answer

Sources of finance

£ Duck Gaming Co.

. Duck is new tech company developing a range of niche computer games
. The three founders are highly experienced tech people with a good track record of developing games and have successfully sold previous companies

…t fin…al optio…re available to Duck?

Wha…rce of finance would you recommend …Duck? Explain your answer

Sources of finance

£ KINGS Haulage PLC

. KINGS is an established haulage company trading profitably for over 50 years.
. KINGs has offices and depots across the UK
. It is now looking to establish a European company and depots across the continent.

[illegible]at fina[illegible]l opt[illegible] are ava[illegible]le to KINGS?

Wh[illegible]ce of finance would you recommend [illegible]r KINGS? Explain your answer

A Level Business: Sources of Finance

Choosing a sources of finance

Factors that influence the decision making process in choosing a source of finance

Legal structure of the business

Flexibility

Sources of finance
Short or long term
Internal or external

ontr

Cost of the finance

Purpose

A Level Business: Sources of Finance

Choosing a sources of finance

Factors that influence the decision making process [illegible] a source of finance

Legal structure of the business

Legal structure can determine what access to finance they can get.

Start-ups, sole traders & partn[illegible]ips have less access becau[illegible] the greater risk.

A Public Li[illegible]ny (P[illegible] has a greater [illegible]e of so[illegible]es of fi[illegible]ce.

[illegible]ies i[illegible] UK [illegible]se capital by se[illegible] shar[illegible]n the Lo[illegible]n Stock Ex[illegible]ge.

C[illegible]trol

[illegible]aisi[illegible]ance[illegible]en involves selling [illegible]es in [illegible]y.
[illegible]hareho[illegible]s will [illegible]a say in how the b[illegible]ess is managed.

I[illegible]ay be that 'new' shareholders are greater than the 'original' shareholders.
These 'new' shareholders will have control.

Sometimes shares issued do not have voting rights – but are less attractive to investors.

Flexibility

Different sources of finances have have different levels of flexibility.

A bank overdraft is perhaps the most flexible – it is there when needed. It is limited but can be negotiable.

Factors that influence the decision making process [illegible] hoosi[illegible] a source of finance

Cost of the source of finance

Rate of interest: loans are paid back with [illegible]rest – [illegible]be a significa[illegible]st
high risk businesse[illegible]trac[illegible]her ra[illegible]f interest

Cost of selling shares: a s[illegible]re is[illegible]s a goo[illegible]ay to ra[illegible]apital – but it is an expensive process
[illegible]ministrati[illegible]gal a[illegible] promoti[illegible] costs are high
a rights issue is [illegible] of shares to existing shareholders, it is easier and cheaper

Oppo[illegible]ity cos[illegible] e[illegible] decisi[illegible] on what source of finance to use has a consequence that affects the bu[illegible]g. using retained profit means less profit to pay as dividends to shareholders

E[illegible] busine[illegible]s to decide which source of finance has the lowest possible cost

Factors that influence the decision making process [illegible] choosi[illegible] a source of finance

Purpose for finance

Short or long term: overdraft – flexible and e[illegible]
mortgage – cheape[illegible] the [illegible] term [illegible] property

Large or small amount: am[illegible]nt o[illegible]nce av[illegible]ble hel[illegible] determine source of finance
[illegible]nture capi[illegible] shar[illegible] sue- reta[illegible]ed profit = large amount of finance
overdraft – loan [illegible] a[illegible] amount of finance

Start-[illegible] l[illegible] choice[illegible]
ris[illegible] nture capital - crowdfunding

Di[illegible]rent sit[illegible]ns - different times help to decide the most appropriate source of finance

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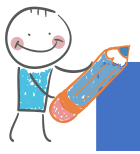
Choosing a sources of finance



	Statement	T	F
1	Start-ups have a large range of finance options		
2	A bank overdraft is a very flexible finan[illegible] option		
3	The riskier the b[illegible]ss the hig[illegible]he interest ra[illegible]harge by a bank[illegible]		
4	S[illegible]g sha[illegible]s an e[illegible] and cheap way to rais[illegible]apital fo[illegible]m[illegible]s		
5	[illegible]ortg[illegible] are a g[illegible] source of finance for property		
[illegible]	The legal structure of a company makes no difference to the sources of finance available		

	[illegible]atement	T	F
7	[illegible]he[illegible]oice o[illegible]ce has consequences for the business		
[illegible]	Selling shares can mean giving up control of the company		
9	Large of amounts of finance can be borrowed via an overdraft		
10	The London Stock Exchange is where shares in companies can be bought and sold		
11	New share issues always have no voting rights		
12	Financing through retained profits means reduced dividends for shareholders		

LO: Understand how decisions are made about choosing a source of finance

Exam style questions

Short answer questions

1. Explain why a business may choose a bank overdraft as a source of short term finance.

Exam style questions

Short answer questions

2. Under what circumstances might a business prefer to use debt financing as a source of raising money.

Exam style questions

Short answer questions

3. What are the benefits of a new start-up using venture capital?

Additional notes