Sources of Business Finance

Finance method	Explanation	Benefits	Drawbacks
Owner's Funds	Money put into the business by the owner	▪ No need to pay interest on the money	▪ Could have been invested elsewhere, earning a higher profit ▪ Owner may not have enough funds to meet the needs of the business
Retained Profits	Money kept in the business by the owners Known as retained profit on the balance sheet	▪ No need to pay interest on the money	▪ Could have been invested elsewhere, earning a higher profit ▪ The business may not have enough retained profit to meet its needs ▪ Shareholders may become unhappy if this means lower dividend payments
Selling Assets	Items owned by the business are sold and the money made used to finance the business	▪ The business is using money it already has – so no need to take on loans or pay any interest or charges	▪ The business has to have something worth selling for this to be an option ▪ The business may sell something they later need
Overdraft	The bank allows the business to draw more money from their bank account than they actually have in it	▪ Very quick to arrange ▪ A good short term solution to a cash flow problem	▪ Only suitable for smaller amounts and has to be repaid within a short amount of time ▪ Interest or charges are paid
Trade Credit	Items are bought from suppliers on a 'buy now pay later' basis	▪ Gives the business more cash to use in the immediate future	▪ Can only be used to buy certain goods ▪ Bills usually have to be settled within 30,60 or 90 days
Debt Factoring	The company sells a debt it is owed to a debt factoring company who pay the business a smaller sum than they were owed	▪ Allows the business to get money for debts that might otherwise never have been paid ▪ Saves the business time chasing customers etc for money owed	▪ Time consuming to arrange ▪ The business receives less money than it was originally owed – this may affect profitability
Leasing	Used to help obtain new equipment eg cars The business rents the item from its owner	▪ Cost of the asset is spread over its life ▪ No need to find a lump-sum of money to purchase it	▪ May be more expensive than buying the asset – the owner will want to profit from the deal ▪ The business does not own the asset so it does not appear on the balance sheet

Debentures	Long term borrowing similar to selling shares, but with the promise of repaying the amount lent at a fixed period in time, usually for a set amount of interest	▪ A very structured method which allows the business to know exactly how much interest will be paid and when the debt has to be paid back	▪ Usually 'secured' onto assets of the business such as property, therefore if the interest on the debt, or the debt itself isn't repaid, the debenture holder will claim the item/property ▪ No longer a popular method of finance for businesses
Bank Loan	An amount of money is borrowed from the bank, then repaid (with interest) over a set period of time	▪ Easy and quick to set up ▪ Large amounts of money can be borrowed ▪ Structured repayment term	▪ Interest payable ▪ If repayments cannot be kept up, the business risks getting a poor credit rating or being made bankrupt
Issuing Shares	A share in the business is sold to an individual or another business. This money then used to purchase new assets	▪ No need to repay the money invested ▪ Cheaper than a loan. ▪ Some businesses can raise large sums of money this way	▪ Need to pay the shareholders a share of future profits ▪ Ownership also means some influence over how the business is run – the original owners may lose control of the business ▪ Risky for the shareholder - the investment may be lost if the business fails
Mortgage	Long term loan provided by a bank in order to buy property	▪ Only method available to buy property ▪ Structured repayments over a long term (25 years)	▪ Large sums of interest charged ▪ Can take a long time to repay debt
Government Grants	Money given to the business by the government. Used to help finance new projects – especially those that create new jobs	▪ No need to repay the grant	▪ Limited funds are available ▪ May be restrictions on what the money can be used for
Hire Purchase	An item is bought on finance, repayments are made each month until the final payment when the item becomes the property of the firm	▪ Flexible method – can hand back the item if no longer required and payment will stop	▪ High interest often charged ▪ Item doesn't belong to the business until the end of the term
Micro-Finance	In many low-income developing countries, traditional commercial banks have been very unwilling to led to poor people because the small size of the loan means that the bank will not make a profit and that the poorer groups in society cannot offer a collateral. The institutions that lend the poorer people money can include postal savings bank, finance cooperatives, credit unions and development banks.	▪ Specialist institutions have been set up in most developing countries to meet the financial needs of poor people – especially poor entrepreneurs. This lowers unemployment and helps in raising the standards of living of the people.	▪ There is a risk on non-payment by the borrowers since the chances of failure are higher than most. ▪ The profit generated is very low because the size of the investment is very low.