<u>Sources of Finance</u>

When a business considers any form of finance, it should look at ways to finance within the business. E.g. before a business takes out a bank loan it should consider:

- Increasing its sales
- Reducing its inventory
- Reducing the credit allowed to trade receivables
- Increasing the credit taken from trade payables

Larger businesses, such as retailers, are likely to not be able to depend on internal finances. They will require an amount of external finance, such as:

- Owner's capital – for sole traders
- Partner's capital – for partnerships
- Bank overdraft – for sole traders, partnerships and limited companies
- Bank loan - for sole traders, partnerships and limited companies
- Mortgage - for sole traders, partnerships and limited companies
- Ordinary shares – for limited companies, both private and public
- Debentures – for limited companies, both private and public

Sources	**Features**	**Advantages**	**Risks**
Owners and partner's capital	Funds provided by the owner or partners. Funds generated from profits can be used to provide finance.	Fully flexible – funds can be provide and taken out needed. Legal documents not required to raise finance.	Owner or partners may not be able to provide to the business. Business may not have enough funds made from profits to finance new assets.
Bank overdraft	Allows customer to borrow money up to a certain limit. Interest is paid – usually at a variable rate.	Bank Overdraft is very flexible – can borrow and pay whenever. Can be economical to operate.	Interest rates for bank overdraft can be higher than bank loans. Security, possibly the business owner's house, is required for an overdraft.
Bank loan	Finance provided by bank for a specific purpose, often the purchase of an asset. Bank loan is set for a time period.	Easy to budget for because repayment dates are known. Favourable interest rates can be negotiable.	A business loan is a long-term financial commitment which will need to be serviced. Security, possibly the business owner's house, is required.

Mortgage	An arrangement in which property is used as security for borrowing. Banks can offer finance for the purchase of the property, usually up to 70%.	Easy to budget for because repayment dates are known. If a fixed rate mortgage is taken with relatively low rates, then the cost of borrowing is relatively low.	A mortgage is a long-term financial commitment which needs to be serviced. The mortgaged property is the security, and if payments are not made then the lender will send the property.
Limited company ordinary shares	When a limited company starts up, it obtains finance from issuing ordinary shares to its owners and other investors who become its shareholders. Shares are issued in return for payment.	Issuing a share can potentially raise more finance than a sole trader or partnership. Can also attract new management with valuable skills and expertise.	Outside shareholders will have an element of control over the company which could be disruptive for the existing management. If the company 'goes bust' then the ordinary shareholders are normally the last people to get their money back.
Limited company debentures	Debentures are a fixed interest, sometimes known as loan notes. Only relates to loans made to the company but do not give any rights of ownership to the company.	Debenture holders are unable to vote at shareholder meetings and are unable to be part of managing the company. Interest is paid at a fixed percentage rate.	If the company does not make profit, the interest will still have to be paid. Debenture holders are often given better rights than ordinary shareholders to obtain repayment if the company 'goes bust'.