Financial advice, sources of credit and savings and investments

Sources of finance are where finance comes from.
For example,
* Bank loans,
* Owner's (share) capital,
* Trade credit,

The Times 100 MFI case study shows how MFI was able to obtain finance for an expansion programme through sale and leaseback. It sold some of its properties and then leased them back over a period of time, freeing up the cash to invest in growing the business.

Finance - money - is a scarce resource. To obtain it, a business has to compete for it. Individuals, the government and other businesses all seek money to finance their needs. Those with money to lend will lend it provided the rate of return (interest), the risk and flexibility (how quickly the money can be repossessed) are consistent with their expectations.

The word 'lend' often implies short-term; the word 'invest' implies long-term. Individuals or organisations that lend money, expect to get their money back, with a fixed annual return in a comparatively short time. Those who invest in a company become part-owners - share holders. They expect regular payment of cash dividends (whose size varies with the company's success) plus an increase in the value of their shares.

A major source of finance for many businesses is the retained profit from sales to customers. A business just starting up or one expanding rapidly has to raise its finance from other sources.

When sourcing finance, management should consider the following questions:
* duration: for how long is the finance required?
* cost: which source of finance is the least expensive?
* epayment: what level is acceptable?

Usually companies will obtain finance from a variety of sources, including:
Internal: Owners' capital and retained profits.
External: Overdraft, leasing, hire purchase, loans, and mortgages.

Duration

Duration depends on the reason the money is needed. No-one would take out a 25 year mortgage to finance the purchase of a personal HiFi. Few people would buy a house with a bank overdraft. Businesses apply the same principles of matching the purpose of finance with the source of finance. This makes sense all round. For the business it ensures that finance is guaranteed as long as it is needed. For the investor it ensures that adequate security is available for the duration of the loan - as in the case of a 20 year loan secured against a property that will continue to have value for all the 20 years.

Cost

In general, businesses look for the cheapest source of finance. The easiest way to compare the cost of finance is to express the annual payment to lenders/investors as a percentage of the amount of finance provided.

Interest on a loan can be expressed in percentage terms. So can the rate of return to shareholders.

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Return on investment in shares = Dividend per share
share price change since the start of year
____x100

Market price of share at the start of the year

The rate of return expected by shareholders becomes the cost to the business of using this form of finance.

Repayment

A business should not get into a position where all of its profits are being swallowed up in interest payments. There is a real danger of borrowing too much. The same applies to individuals.

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