

Sources and uses of finance

There are a number of ways of raising finance for a business. The type of finance chosen depends on the nature of the business. Large organisations are able to use a wider variety of finance sources than are smaller ones. Savings are an obvious way of putting money into a business. A small business can also borrow from families and friends. In contrast, companies raise finance by issuing shares. Large companies often have thousands of different shareholders.

Source of finance	Use of finance
Stakeholders	Finance to start up and expand a business.
Bank	Loans to finance capital projects. Overdrafts to manage cash flow.
Creditors	Short term credit until goods have been sold.

To gain extra finance a business can take out a loan from a bank or other financial institution. A loan is a sum of money lent for a given period of time. Repayment is made with interest. The lender of money needs to know all the business opportunities and risks involved and will therefore want to see a detailed business plan. The lender may also want some form of security should the business run into financial difficulty, and may therefore prefer to provide a secured loan.

Another way of raising short-term finance is through an overdraft facility with a bank. The borrower is given permission to take out more from their account than they have put in. The bank fixes a maximum limit for the overdraft. Interest is charged on the overdraft daily.

Businesses may also qualify for grants. Government and private funds are sometimes made available to businesses that meet certain conditions. For example, grants and loans may be available to firms setting up in rural areas or where there is high unemployment.

A small business can also attract extra finance by taking on a partner or by selling shares. The problem caused by bringing in extra people is that profits have to be shared.

A further way of raising capital that has become popular is that of venture capital. Larger businesses with cash to spare have been putting funds into small- and medium-sized enterprises.

Once a business is up and running there are various ways of financing its expenditures. Expensive items of equipment can be leased. Rather than buying the equipment the business hires it from a leasing company. This saves having to lay out sums of money and the business does not have to worry about having to carry out major repairs itself. Motor vehicles, machines and office equipment are often leased.

Hire Purchase is an alternative way of purchasing items of equipment. With a leased item you use and pay for the item but never own it. With hire-purchase you put down a deposit on an item and then pay off the rest in instalments. When the last instalment has been paid you become the owner of the item.

Another common way in which firms can finance their business in the short term is through trade credit. In business it is common practice to purchase items and pay for them later. The supplier will normally send the purchaser a statement at the end of each month saying how much is owed. The buyer is then given a period of time in which to pay.

Large companies like Argos will raise finance in a variety of different ways. Not only do they raise capital from shareholders, but they also take out loans from banks to finance major capital projects. Capital equipment such as vehicles and computers may be leased. In turn these companies will provide finance.