

### 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.

| Sources of finance | Uses of finance  |
|--------------------|--|
| Shareholders       | Finance to set up and expand a business                          |
| Bank               | Loans to finance capital projects. Overdrafts to manage cashflow |
| 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 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.

A further way of raising funds that has become popular is through venture capital. Merchant banks and investment specialists may be willing to provide finance for a promising and fast-growing smaller business. This usually involves a package that is a mix of share and loan capital.

Businesses may also qualify for grants. Government (or EU) assistance and funding is 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.

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.