Sources of finance

The Main Sources of finance available to a firm can be broken down into two main sections, Internal Sources and External sources.

Internal Sources -

Retained Profit -This source of finance is linked with the profit left in the business at the end of the accounting period after all deductions and appropriations have been made, such as paying tax. This is a very useful source of finance it is used to invest within the business to expand and diversify as it holds no risks it is a widely used financial source, in the long run it is very posative for the business because reinvesting into th efirm means share rpices will rise. However this can only be produced per anum or monthly.

Working Captial - Working capital is the amount of money that a company has tied up in funding its day to day operations for example without the value of its fixed assets and other investments, this is a very short term means of finance it requires a strong hold of the firms cash flow this means keeping an eye on stocks and chasing debtors, this is time consuming but in the short term healthy for a business.

Sales of Assets - The sale of current assets such as raw materials or long term assets such as real estate or equipment to generate finance, this is normally only done when the firm is in trobule with any of the following, the business is facing difficulties and must generate cash in the short term, or the firm no longer needs the assets, or the firm decides to sell of assets to alocate funds for a new venture. This is a way of making money at the expense of assets normally a short term source of finance, it can be risky becuase value of assets may drop. Most useful when the business is in trobule.

External Sources -

Share Capital - Money put into a business by its owners for use by the business in acquiring assets and retained profits, this money is generated by the sale of shares.This is a very long term of finance because the business will always have shareholders who own these shares. This can be very usefull when starting a new business or expanding the existing one, the risks within this source of finance are that majority of shares may be bought thus the business may change ownership, it also means many people have their say in the business may it be limited.

Venture Capital - Venture Capital is the process by which investors fund early stage, more risk oriented business endeavors. A venture capital funding arrangement will typically entail handing over some level of ownership and control of the business. This is very useful when a firm has plans to expand, it is a long term source of finance although in a fast changing industry it can be offered as a medium term loan. It involves no risk for the business but is a risk investment for the individual or merchant bank that is investing.

Loan Capital - A form of debt, which has to be repaid at a specific time in the future, as distinct from a bank overdraft, which the bank may call in at short notice. this is a source of finance which is less used by firms because it involves interest. There are 3 types of loan capital ,

Debentures - A long term loan made to a business at an agreed fixed percentage rate of interest, repayable on a stated date.

Bank Loan - Sum of money provided by a bank to a firm for a specific agreed purpose.

Bank Overdraft - When a bank allows a firm to overspend its current account up to an agreed overdraft limit.

Loan capitals provide flexible sources of finance for different needs, the 3 types rang from short term borrowing such as Overdraft and long term sources of finance such as Debentures. The risks that come with these types of finance sources are interest this can cause major debts if it is allowed to grow! These terms of finance are usefull when used correctly, such as a using an overdraft but paying it off before the interest starts.

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AS level business studies text book

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