Task 1

Sources Of Finance

Organisations in the private sector are split into four types of ownership structures, these are a sole trader, partnership, private limited company and a public limited company these businesses essentially need finance for many different reasons, these may be for long term or short term uses. The main types of financial backup that is needed for businesses are for starting a business up, expansion and development or maybe the business has just run out of money that is needed for it to be successful.

There are many sources of financial help an organisation can turn to for funding and can be different depending upon the business ownership and structure as some are more appropriate for the need of the business than others. These are categorised as the providing of the financial fund can be obtained within the business and out side the business.

Internal sources-These are the main types of financial help that most businesses can get access to freely. Limited companies use these more than other business ownerships.

- Personal savings
- Sale of assets
- Retained profit
- Working Capital

External sources

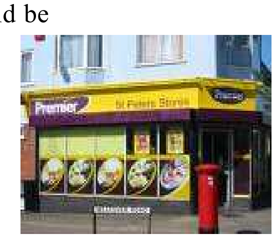
Ownership capital

- Shareholders

Non ownership capital, financial sources that are not shareholders.

- Loans e.g. debentures
- Overdraft
- Hire purchase
- Grants
- Venture capital
- Leasing

A **sole trader** is the simplest and easiest type of business to set up as there are no legal requirements to comply with; all there is to do is start trading. The down side of being a sole trader is that they have unlimited liability, which means that if the business goes bankrupt the sole traders personal assets may be taken to pay off the unpaid debit if the business has run out of money. But the advantages are that all of the profit that is made from the business is the sole traders to keep as they are their own boss. There is basic financial help that this type of business venture can obtain; the most commonly used for small enterprises are their own **personal savings**. This is money that the individual has free access to and can do with as they wish. This could be used to invest in setting up the business, so then when the business is making a profit the savings can be put back. The advantage to this is that it dose not have to be paid back at all as it is the owners, or at least not until the business is making enough money to make a profit. This means there are no constraints of using the money as it is the individuals own that they are investing. This is an internal source of finance. (An example of a sole trader is the small corner shop shown in the picture on the right.)



Task 1

Partnership is two individuals setting up a business and having equal share of how it will be run and the profit that is made, this is usually summed up in a partner's agreement which is a legal document stating the rights of each partner. This has the same unlimited liability as a sole trader but has two or more people to share the risk with if the business is unsuccessful. The business venture can also have other investors who are called sleeping partners, as they invest their money in to the business but do not get involved in the day to day running of the company. It is up to the main partners to make it successful by achieving their stated aims and objectives. A good source of financial help a partnership business can use is to obtain an **overdraft** normally from a bank to help with the running cost of the business. This is more suitable for a partnership business as the overdraft is usually paid back in a shorter space of time than a bankers loan would be, which means lower interest rates and there is also two partners involved in this type of company that can help to pay the debit off more quickly. An overdraft is usually used when businesses have a small cash flow problem from time to time and can be solved from borrowing a sum of money that can vary in the amount depending on its need; this can usually be paid back quicker than a bank loan would be when the business is more successful. These are obtained from banks on a current account and have a lower interest rate than a long-term loan.

Private limited companies are owned by a number of individuals who have shares in the business and all have the same responsibility and rights as each other. This type of businesses liability is limited unlike a sole traders or partnership which is unlimited, this basically means that if the business is in bad debit it is the businesses debit and not the owners (shareholders) so there is no risk in them losing their personnel assets like their house etc. Private limited companies are usually family owned businesses with the family members running the company. To set one up it must be registered at a companies house and the firm must have various legal documents for it to be formed legally and compile with many regulations. **Shareholders** is a easy way for a private limited company to obtain finance within the business as this means that the shareholders are providing money to help the business survive financially and in return the business will pay the shareholders a sum of money which is called dividends as they are investing their own personal money to make it successful. This is beneficial to the business as there is a continuous flow of finance as there can be more than one shareholder investing in the business, but the problem is if a shareholder sells their shares it may be hard to find some one to buy them straight away. This could put the business at risk of going bankrupt or not running effectively as it should do as there may be a problem in the cash flow that makes the business run effectively and successfully as it needs to do to survive.

Public limited companies have shareholders like a private limited company but the difference in ownership is that any individual can buy shares on the stock exchange. There for any one can have ownership of the business even if they have no experience in running one, this may be an disadvantage to the businesses success as some shareholders may be investing so that they can make more money and are not interested in the actually running of the business and making it a successful one. There are a lot of legal requirements a plc company has to abide by as they must have a minimum of two directors and a fully qualified secretary in order to become a legalised business, then they have to produce annual reports and accounts for the companies house so that they can keep there records up to date. **A bank loan** can be used as a source of finance to set up this type of business venture, as this is usually a larger type of business structure than most other businesses so is harder to set up financially as well. A bank loan can help in many ways as it is usually a large sum of money that is borrowed over a longer period of time, it can be used for buying premises which can be very expensive, to the stores features and equipment. This usually takes a longer time to pay off but when the business is functioning properly and making sales it can pay the amount from its retained profit. The downside of using this source is that it has very high interest rates and usually an individual's home etc is used as a guarantee that the loan will be paid back even if the individual stops paying the debit the bank will take their home as an other option to cover the existing cost left. Also a business plan is usually needed to obtain a bank loan to show the banker that the business will be a success once set up and their money can be paid back.

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Task 2

If a sole trader had borrowed an overdraft from a bank to set up his/her business venture had decided after the business had being up and running for a while that they wanted to expand to a partnership to share the businesses running cost. But needed additional finance to help them do this then this could be obtained, by the sole traders selling there existing business assets which is also known as sale of assets to make enough money to contribute to the businesses expansion into a partnership. The advantages of using this additional source of finance to develop the expansion idea are:

- Selling the businesses assets that are no longer needed. This is an advantage because the business is getting rid of unused property, machinery, vehicles, fixtures etc, that the business no longer needs to help the business generate finance so can be sold to raise a supply of cash.
- Quick and easy way of raising money for the businesses expansion. (Time saving). As the assets can be sold at auctions or on the internet to help them sell more quickly which means that the additional source of finance can be obtained faster to help expand the business more rapidly.
- The business is getting rid of assets to make the business more successful. This means that the business is losing some of its personal property to contribute to the development and expansion of the overall business so is gaining more in the long run. Such as money to develop the business into a partnership to be able to generate more capital.

There are also disadvantages of using this type of finance to obtain money to develop the business which are:

- The assets are unlikely to be worth as much as they were when they were first purchases especially used cars these tend to decrease in value over the years due to the wear and tear of the vehicle and newer models being made. This also is the same for machinery and some equipment as the long term use of them can cause damage to them. This means that even if the business sells some of its personal assets it still may not raise enough money for the expansion of the business as this can sometimes cost quite a lot of money to set up.
- The business on the other hand can raise more money by keeping their asset in the long run as the assets may be required when the partnership business is set up, which means that they will have to buy the assets again if they sell them when they start up the new business venture which can cost them a lot more than they got for selling the original assets.
- Selling the businesses assets will have an effect on how much it can produce as it has got rid of some of its resources there for it will also affect the potential capital of the business.

Also finance leasing can be used to obtain a sum of money to develop the business quickly. Leasing is a contract between the lessor which will be the leasing company the sole trader sells their assets to and the lessee which is the customers who hires the asset and pays a sum of money which is called rental over an agreed period of time. Finance leasing is where the rental covers virtually all of the costs of the assets and the customers can claim tax relief and vat on the rental payments.

The advantages to using this source of finance are:

- Financial leasing is a better way of earning more money on the asset that is being leased out as the value of the rental is equal to or greater than 90% of the overall cost of the asset it self.

The disadvantages of using this source of finance are:

- The assets that has being leased out may not be returned in the same condition and shape of what it was when it was first leased, this could mean that the item may decrease in value or dose not work properly, so the lessor might have to purchases a new one or pay to get it fixed.
- If the lessor leases the asset with out track record or any agreements then there is nothing to protect the lessor from claiming if the asset is damaged and no terms and conditions of the use of the asset means there are no limits or rights that the lessor can use to protect the asset from misuse.

Both of these financial sources are using the businesses assets to raise money to contribute to the development of the business expansion. The most appropriate source of finance that should be used to solve this situation is by the sole trade using some of the businesses assets to raise additional finance by leasing them out to potential customers. This source of finance is more reliable and dependable than using sales of assets to raise funds as leases are for a fixed period of time and the costs are in form of interest charges for the asset so will generate more money than selling the businesses assets would as this means that the business might need to buy them again in the future were as leasing the assets means the business will get them back at the end of the agreed period.

If one of the banker's partnership customers intended to end the partnership business to expand into a private limited company then other sources of finance would be required as this is a much larger type of business structure. Venture capital can be used to raise the additional source of finance needed to do this. Venture capital is where a company gives up some levels of ownership and control of the business in exchange for capital for a short period of time. The advantages of using this type of finance are:

- Venture capital can be found world wide for example insurance companies etc and the internet can be used to find these. This will help the partnership business as there are many businesses that are willing to invest at the early stage of development in a new enterprise
- This is much easier way of obtaining financial help for the partnership business to use than it would be to get a bank loan or overdraft which would mean paying the money back over a long period of time with high interest rates added to the debit, as no money is borrowed so dose not need to be paid back. Because the venture capitalists invest the money into the business by purchasing shares in the business it self rather than simply lending the money and they gain there money back by selling their shares when the business is more successful so the shares would have increased in value.

The disadvantages of using venture capital are:

- Using this financial source means having less control over the business as the investors buy some shares of it and usually takes 3-5 years for them to sell them when the value has increased. This means that the partners will have less say in the decisions made in the running of the new enterprise and may lose interest.
- This could be time consuming in trying to seek venture capital as this type of finance has increase in businesses using this as a source of finance over the past few years. So can be very difficult in finding venture capitalists to invest in a new enterprise as there are so many new businesses out there.

Another additional source of financial help that the partners could use is their retained profit from their business. Retained profit is money the business has saved from its profits, the advantages of using this are:

- Retained profit is like the businesses own personal savings it has kept for when the business might have cash flow problems, needs new equipment etc. This could be used to invest back into the business for the development of new ideas and can help to expand it.
- This type of finance dose not need to be paid back as it is the businesses own money it has saved from profits, so there are no terms and conditions on the use and no interest charges as it has not being borrowed. This is what the money is there for to be put back into the business to make it more successful.

Using the businesses retained profit to expand the business has no disadvantages of its use as it is being used to develop the business and take it to a different level of success. The only down side could be if the businesses used all of its retained profits to develop the businesses expansion and it was unsuccessful, this means that the business has no money to fall back on and could end up being a waste of time and money spent. Depending on the amount of the business retained profit this source of finance is the most appropriate to use in this situation as it is being put back into the business for which it is meant for and there are no constraints of using it as it is the business own personal money. This financial source can be saved by the business until the right amount has being raised to expand it and can be accessed any time and allow the partners to have full control over the new enterprise as they are investing there own businesses profit, unlike if venture capital was being used, because this can be very time consuming in finding an investor, which will then want some share in the business and some control of it.

Another situation that could be looked at is if one of the banker's private limited company customers intended to convert to a public limited company then more financial help will be needed to develop this as this is one of the most largest types of business structure in the private sector. This finance could be obtained from using government grants to help set up theses types of businesses. Grants are a form of funding awarded by private foundations or other government departments/agencies to successful applicants. They have competitive procedure and strict guidelines so only some selected business can apply for them. The main advantages are:

- Grants do not have to be paid back it is free money given to successfully selected businesses that are eligible for one. It is given to help a business financially to pay for things to make it a success. This is an advantage because it dos not have to be paid back after it has being used for its purpose it was given.
- Any business in an approved area is entitled to a grant theses grants can be very high amounts to help with premises and security to the equipment needed etc.

- The disadvantage of using a grant as a source of finance is even if the business is entitled to a grant it may only be a small sum of money and not actually enough for what it was needed for, also some grant depending on the terms and conditions is that the money given is free depending on the businesses state at the time it was give and when this changes and is more financially balanced some of the money may need to be paid back, it all depends on the type of grant given and the terms of the use.

Hire Purchase this is another source of finance that can be used to help the business raise the additional money needed to develop the business venture into a public limited company. Hire purchases are a way of purchasing assets without paying the full amount up front.

- The advantage of this system is that the company have immediate access to the asset hired without having to invest the full amount it would cost to buy it. This helps businesses who do not have the right amount of finance to pay the cost in full and also eliminates the business from having to borrow money to purchases the item as only a small fee is paid to hire the asset.
- Any businesses can use hire purchases to obtain assets as a business plan or interest rates are not used in this source of finance. It is an agreement that allows the business to use the asset for a period of time, and then the business can purchases the asset for a less amount of the actual cost of the price.

The disadvantages of using this type of financial source are:

- This could cost the business more money in the long term if the asset is borrowed for use in the every day activities of the business; this means that the asset will be continuously hired as it is an essential part of making the businesses a success by operating effectively. So could benefit more from purchasing the asset its self as it would be worth the cost as it would be use continuously and is an important part of the functioning of the business, rather than hiring it as it would mean paying one fixed fee in stead of a continuous hiring fee so could save money in the long run.
- The asset is not owned by the business hiring it as it is still property of the hiring company; this means that if any damage is done to the asset while it is being hired the business hiring it might have to pay the cost of it being fixed which could be quite a high amount.
- Also if the business hiring the stock doesn't meet a payment for what ever reason, then the hire purchase company have every right to take the stock off the hiring company with out there permission or consent to do so.

Task 3

The most appropriate source to use in this scenario to expand the private limited company into a public limited company is to use hire purchase to obtain the most expensive resources needed to make this happen some examples are more equipments and machinery needed to produce more stock or larger premises to develop the business into etc. This is an easy way of obtaining assets than it could be to get a grant because the procedures are so strict it could take along time to see if the business is eligible for a grant, then the business will have to wait to be assessed for the amount they are going to get if they prove successful and this could take even longer to be sent out to them, then depending on the terms and conditions of the grant it still may have to be paid back in the future, unlike hiring the assets which would mean the business can have immediate access of the resources and use them to get the business expansion underway more quickly.

The first choice for the most appropriate source of finance for a business was a sole trader and he/she using their personal savings to help them set up this business venture. This source of finance can also be obtained from the owner's family and friend's personnel money that they wish to invest in the start up of the business. This money can then be paid back if chosen to when the sole trader's enterprise is making an income of profit. Savings is money that can be used as the individual chooses to without any added interest charges as it does not have to be paid back at all as it is being used for the individuals own pleasure. This is a simple source of finance that suits a small sole trader business as this structure usually dose not need many employees and tends to have a small product line that it offers, usually something the owner is interested in or has for a hobby. This financial source will help the business in the short term for example setting up the business, purchasing goods, fixtures and fittings of the business property etc. To enable the sole trader to start selling and earning profit, which will cover them in the long term as this is what the owner is in business for (Provide goods/services and to make a profit). Because there is a high risk in being a sole trader and what the consequences are if the business was not successful, the owner prefers to use his/her own money to develop this as it means the business is in less debit and seem like a less risk that they are taking..

For the partnership business the choice of finance was obtaining an overdraft. An overdraft is a loan that is borrowed from a bank and is usually a smaller sum of money is borrowed than a bank loan. The partnerships will both have joint liability of the overdraft as well as several liability this means as will as the partners equally having to pay the overdraft back they will also have to pay the other individuals money to the bank if the have a dispute and one of them moves away and stops paying the debit. The borrowed amount is usually paid back in a short space of time, this can depend upon the amount borrowed as interest charges are still added which may rise over the period of time the overdraft is borrowed for, this would mean that the overdraft would increased in value as it would be more expensive to pay so could take a lot longer to pay it off completely. How ever an overdraft is normally used as a short term source of finance that can help a business if they are experiencing small cash flow problems that can some times happen within a business. The partnership would then have to plan for the future survival of the company financially when the overdraft has been used for example can the business afford to pay the agreed amount back in the long term?, what would happen if the interest charges did go up can the business afford it?. Overall a overdraft is a good source of finance as it can have a lot less demands than borrowing a bank loan would have and this is more appropriate for a partnership as this business venture is usually two individuals that can help to pay the amount back, unlike a sole trader. This would be a bit risky for a sole trader to use a overdraft as a source of finance as they may not be able to pay it back in the future as there is only one person taking all the risks where as within a partnership there is two individuals taking all the risks. Also an overdraft would allow the partners to obtain the right amount of money they needed with lower interest rates from a bank load because a partnership business would not need an excessive amount of finance as this type of business is similar to a sole trader and dose not need a lot of money to set up or run.

A private limited company can obtained financial help from shareholders within the business. Shareholders are individuals who invest their own personnel money into a business of their chose and to declare that they have a share of the company they are given a certificate to proof how many units of investments they have in a limited company and dividends is paid out to the shareholder once of twice a years, the amount and certainty that the dividends will get paid out depends on the type of category their shares are in.

- Ordinary shares or
- Preference shares

These are the two main types of shares within a limited company. Ordinary shares are also known as equity shares these are the most common type of shares in the UK. This has a lower risk than preference shares as these are often entitled to a fixed dividend even when ordinary shareholders are not. Also if the business when bankrupt or liquidation happened then preference shareholders would be paid out first as they have a higher priority over ordinary shareholders. Ordinary shareholders are expected to be paid dividends out of the business profit once of twice a year but if the business is having financial difficulties then they may not get paid at all simply because the business cannot afford it but preference shareholders would still receive there fixed dividends as this is compulsory. How ever preference shareholders cannot normally vote at general meetings that take place in the company but ordinary shareholders have the right to do so. This financial source is a great way for a private limited company to get an on going amount of finance to help the business in many ways for example development and expansion ideas to take place, as shares can be sold for higher prices if the business is successful as the value of the share will rise. This source helps a private limited company to obtain large amounts of money in one go when share are bought, this contributes to the success of the business as there is a continuous flow of finance. How ever some times shares can take a long time to sell which can cause the business to struggle financially during this period. But overall is a good way for a private limited company to obtain finance as it is an option that they have open to them unlike unlimited companies.

The final type of enterprise in the private sector is a public limited company this could use a bank loan to obtain finance as this is more appropriate for this kind of enterprise as it is a much larger organisation than most other business structures in the private sector. A bank loan is similar to an overdraft but the main differences are that the business can borrow a much higher amount than they would be able to using an overdraft which would also mean higher interest rates would be added on top of the amount borrowed. The public limited company would need a business plan of the company to determine whether the organisation can afford to borrow the amount that they wish and pay it back in the future, because of this uncertainty the bank would agree to use another personal belonging or asset to cover the cost if the business did not keep up with the repayments this could be the individuals house, car, business etc. This is known as secure lending to secure the loan is going to be paid back. It would be more appropriate for a larger business to use a bank loan than a smaller enterprise as this type of business would need it much more because they would have a higher number of employees to pay as well as demanding suppliers as public limited companies tend to offer a variety of products. So overall a bank loan is more appropriate for a public limited company as it would be required more as there is more need for it has it would have higher prices on the assets it may need.

For each expansion scenario:

It would be more suitable for a sole trader wanting to expand into a partnership to use leasing as an additional source of financial help rather than sales of assets, because the business would make more money as they would receive an income off the leasing company who would lease their assets for them unlike if the business sold their assets which would be one payment and depending on the item this may be not a lot of money to help the sole trader start the development of the expansion idea as goods tend to decrease in value over the years as well as the assets been second hand this will also effect the selling price. Leasing is a continuous supply of income as the lessee would pay rental on the asset being leased out to them which would cover the business in the long term as well as short term, this would be more appropriate as it would benefit the sole trader more due to having unlimited liability this would not put the sole trader at risk of having debt unlike if he/she sold the businesses assets which would effect how much the business can produce so would effect its capital which is what the sole trader uses to pay its suppliers and other business costs so if this decreased the business would increase its chances of going bankrupt which is a crucial issue for any unlimited business, where as leasing allows the sole trader to have a supply of income from their assets after they have gone. Also because a partnership business is very similar to a sole trader leasing would allow the sole trader to expand gradually but quickly as all there is to do is become a partnership with another individual and sell more stock to make enough profit to be shared out between two people, so selling the businesses assets would not be a good idea as it limits what the business can produce.

For the second scenario retained profit was chosen as the most appropriate source of financial help to use over venture capital if the owners of a partnership business decided that they wanted to become a private limited company. Simply because retained profit has no draw backs of it being used unlike venture capital which has a high risk factor because strangers would own parts of the business as they would be investing their personnel money to allow the expansion idea to be set up, which would mean that the partners would have less control over the business as the rights are shared out equally over a higher number of people. This could last for a few years as the investors would want to keep their shares within the company to allow them to increase in value if the business is successful which also has a 50/50 chance of being. How ever retained profits is kept and saved to be used within the business to help develop it or help when it is experiencing financial difficulties. This is a good source of finance for a partnership enterprise to use as it also means it is not putting the business in debit as it has also got unlimited liability like a sole trader. The retained profit could be saved until there is enough money to expand the business which would allow the partners to keep and have full control over the new development.

The last scenario is where a private limited company converts into a public limited company; the most appropriate source of additional finance to help the business expand is to hire the assets needed to develop the business in to this other form of enterprise because a grant is to unreliable. Even if the company applied for a grant they would have to wait a long time to be told if they are entitled to one or not which would mean if they cannot have a grant they have wasted time in which it could of being used to find a more reliable type of financial. Hire purchase allows the business immediate access to the equipment and machinery that they need to become a public limited company as this will need more assets to produce more goods as this type of business is a larger enterprise than a private limited company so will need to make more profit to cover the businesses running and fixed costs to survive. How ever the private limited company could use hire purchase to make more income by hiring more equipment to make more products to raise more capital to gradually expand into a PLC company. This seems like the most appropriate source of financial help to use as a grant has too many regulations and requirements needed to be able to be obtained.