AO1 Unit 3 Finance

There are a number of sources of finance, which businesses will need in order to start up a new business, make their business expand and buying materials required for their business.

- Mortgage: A Mortgage is a source of finance that is used to help fund purchase of a property. This is a very long-term method of borrowing money which requires some form of security. The money will later have to be paid back to the bank along with interest. If this money is not paid back there are people who are known as bailiffs who will come to your house to repossess the belongings needed to pay off the mortgage taken out. Mortgages can be borrowed by Company, Building society or Bank.

Advantages

The Advantages of this method are that the interest charges tend to be lower than other sources of finance. Also you can take out the money for long period of time, this can be easier for a business because it'll give them a chance to set up and keep the business running and then later on if the business becomes successful and makes a lot of money, and they can then pay off the mortgage which was taken out.
You can Retain Ownership; this means instead of raising funds by selling a share in the property or the business to an investor you retain complete ownership. There is also Tax Advantage because interest expenses on your mortgage are tax deductible and are made with pre-tax money.

Disadvantages

The Disadvantages using this method are that the longer you take to return the money, the higher the interest rate. Another disadvantage is that if the mortgage is not paid back, debt collectors will repossess your belongings so that you can pay back the mortgage.

-Bank Loan: A Bank Loan is an amount of money borrowed from the bank and then has to be repaid with interest on or before a fixed date. Bank loans are taken out for a fixed period, banks would want some form of security to certify that the bank loan is paid back including interest along with it. A bank loan is usually taken out for a purpose e.g. borrowing money to start up a new business, providing new equipment for their company, buying stocks, buying new products to sell in your business, even buying shares or using the money to invest in the business. This is comparable with mortgage

because with a bank loan you also have to pay back the money along with interest.
Many business owners who need financial help in their business will go to the bank straight away to take out a loan, but most businesses that become unsuccessful or bankrupt will find it difficult to pay back the money which had been borrowed and will then be in debt. If the business is then in debt they will have to find a way to pay back the bank, if they are unable to pay the debt they will then have to talk to the bank to ask for them to allow the business more time to return the money along with the interest. Also with the bank loan many businesses will continue buying more equipment or purchase more goods in order to keep the business running because sometimes a business is made successful because of the quantity and quality of the product or equipments needed.

Advantages

The Advantages of this financial method are that there are wide varieties of ways to spend the money secured from a bank loan. A bank loan can be secured quickly. As soon as the bank loan is secured, the qualified borrower can then complete a bank loan transaction. A bank loan can be used in a number of ways; this money can be used for large items such as cars or any other sort of vehicle, furniture, investment etc. A bank loan can provide much needed funds for a borrower. These advantages take a big effect from the loan.

Disadvantages

The Disadvantage is that when people borrow too much money, they get trapped by their debt. Some loans have a down payment penalty, which prevents the borrower from paying the money off before without incurring extra cost. There are a number of limitations on the contract e.g. there might me conditions on the way the money is used.
Also one of the disadvantages is that there might be a fixed date on which the loan has to be paid back. Borrowing too much money can lead to a messed up cash flow and also payments can even overtake income in some matters of cases, this is why many loan payments are limited to a certain proportion of a borrowers income. And another disadvantage is that you have to pay back 100% of the money borrowed plus an interest rate. The interest rate depends on how long you take to pay the money back; the longer you take, the higher the interest rate.

-Government Grants: A Government Grant is financial assistance which is not a loan and doesn't need to be paid back. A government grant is a sum of money that has been given to the business or company for a specific purpose. The grant can be used to start up businesses, and is available to help anyone. A grant will frequently only cover part of total costs usually involved, and this could vary anywhere between 15-75%.
Grants come from a range of sources:

- The Government
- The European Union
- Local Authorities/Local Council
- County Enterprise Boards
- Regional Development Agencies
- Chamber Of Commerce

Grants are related to specific areas of business activity, such as exporting new product improvement, training or a particular industry area. In addition there are some grants linked to specific geographical areas which are in a desperate need of financial renewal.

Advantages

Advantages are that those who receive government grants find it easier to raise money from other government and private sources. Also an advantage is that you are getting help from the government during times in which you need support.
Also these grants can be impressive and give your business immediate credibility and public exposure. And one of the most important advantages is that you don't have to pay the mo ney back, most importantly no interest.

Disadvantages

Preparing government grant proposals usually require hard work and tons of research and planning. Government grants come with requirements to spend the money according to a difficult set of regulations and laws that could increase your bottom line as you may need the knowledge of an attorney, accountant or any other professional.

Another disadvantage is that you aren't getting enough funds to start up your business, also you are not getting great am ounts of money for your business, you only get a reasonable amount of funds which are just enough to buy materials and resources for you business. Government grants often come out with a set of rules for the person who is eligible to apply which can be so specific that it prohibits many businesses. And there may be an increase in the businesses expenses because they tend to demand certain activities which have to be included in any project to be funded. Also government grants are very competitive. And many businesses are going after the same bag of funds.

-Owners Capital: Owners Capital is the owners of the businesses money/wealth. The owners invest their own money in the business to help keep the business running and also pay the businesses debts. The business owners are the ultimate risk takers as they provide the business with capital (money invested in business to help the business) and expect a return only if the business proves to be profitable and successful. Sources of owner's capital are:

- Personal Savings
- Sales of Assets (sales of what the business owns or is owed)
- Or loans from financial assistance

Sales of Assets of the business belong direct to the owners or partners.

In addition, the owners may be forced into transfer more personal wealth into the firm if the business cannot produce enough money (funds) to pay its debts.

Advantages

Advantages of using this method are, if the business is under a bad year (meaning they have not done well enough), the company is under no authorized commitment to pay shareholders. Unlike loans, whereby the principle has to be returned at the end of a period on a contracted date, the company doesn't need to pay back the share capital. Interest on loan capital is an operating cost that reduces profits, whereas share capital doesn't create costs.

Disadvantages

Disadvantages could be that the creation of more shareholders may reduce the influence of the company's founders and therefore affects their ability to make decisions. Other disadvantages are that it can be expensive to issue shares. Also companies have to endure the exact financial requirements of the stock exchange to be scheduled, and demands for shares are question to the doubts of the marketplace. Also one big disadvantage is that the business may not make much profit, which makes the owners in loss; because this means that the owners don't get what they invested, back.

-Family & Friends: Borrowing money from family & friends is a good way to start up a business because you are borrowing money from people you know, and you can take as long as you want to repay it back. There is also no form of security that you have to provide to get the money. Also if the business turns out to be profitable you can repay your family/friends back, without interest. On top of that, family/friends can then trust you to borrow more money off them, and ask for financial support. Using this financial method the right way can meet your financial needs by taking out a loan from family/friends and this stops you from getting confused from taking out a loan from the bank because they don't charge interest.

Advantages

Some Advantages are that you get no hassle from the banks that require paperwork, because this method is paperwork free. Also you won't be under pressure to pay back the money on a fixed date because there is no time period in which you have to pay it back; you can take as long as you want to repay your family/friends unless they need the money back by so and so date. There is no form of security needed in order to borrow the money; this makes it easier to borrow money from family & friends because unlike banks, mortgages etc they don't ask for any forms of security, which is an easier option. Another advantage is that there is no interest charge, which is a very good advantage because you wont have to worry about paying back extra money on top of the money borrowed as it is. Also this method is based on trust.

Disadvantages

Family/friends might want their money back on short notice; this could affect the borrower from failing to give 100% money back as their loan is not ready to be paid back yet. And then the family/friends may not trust you to borrow money off them again. Another disadvantage could be that your business may not be able to run properly and maybe even duffer a loss meaning, you are unable to pay back the money if you don't make any money from your business. Also during the process of a loan, relationships can be broken. And any problem in the agreement could cause issues in personal relationships which could be a big problem as you won't be able to take a loan of them again or you can't seek any further financial support from them.

-Overdraft: This method charges the business interest due to the amount of days the money is borrowed, because the money from an overdraft belongs to the bank. This method lets you overdraw extra money from the bank; they are a good backup to guarantee you can pay your bills even when you have not yet received your debit payments.

Advantages

Advantages of an overdraft are that it is flexib le, because it is there when you need it, a costs nothing apart from a possible small fee. . It allows you to make necessary payments whilst c atching up your own payments, and helps to continue cash flow. You only need to borrow what you need at the time.

Quick – Overdrafts are easy and quick to arrange, providing a good cashflow backup with the minimum of fuss.