Sources of Finance

prof.Vivek chavan

Dr.M.W.P.W.S. ARTS AND COMMERCE COLLEGE

Why do we need to study finance?

Almost half of ventures fail because of poor financial management

What is Finance?

- Who needs money?
  - Every one? you?
  - Can you or a business survive without cash? Why?
- So what is Finance?
  - First, how to have money
  - …

Personal finance

- Where does money for individuals (personal finance) come from:
  - Our own money in pocket
  - Borrows: from friends or credit cards
  - Received from Government if entitled to some benefits
  - Earned by doing something or sales of products and services

Business finance

- Business finance: a business has the same source of money for individuals
  - Its own money
  - Borrows: from friends, colleagues, banks and lending institutions
  - Received from Government grants. Eg. new in deprived sectors
  - Earned by sales of products and services
  - From venture capitalists (seeking profit for spare funds)
  - From private individuals (Business Angels – often seen in entertainment sector)
  - Private companies
  - Microloans

To obtain funding for a business project

- Determine how much money is needed to start your company
- Prove to your investor that your company requires the predetermined amount of money
- Offer incentives, interest, or collateral for the investor's contribution
- Make arrangements to pay back the loan

Classifying businesses

- Each type of business can have different ways to finance itself, so we need to look at types of business ownerships
  - Sole trader – owned by one person
  - Partnership – owned by two or more and based on agreement among them
  - Limited company: owned by two or more but separate in law from people who own and control

Business Forms

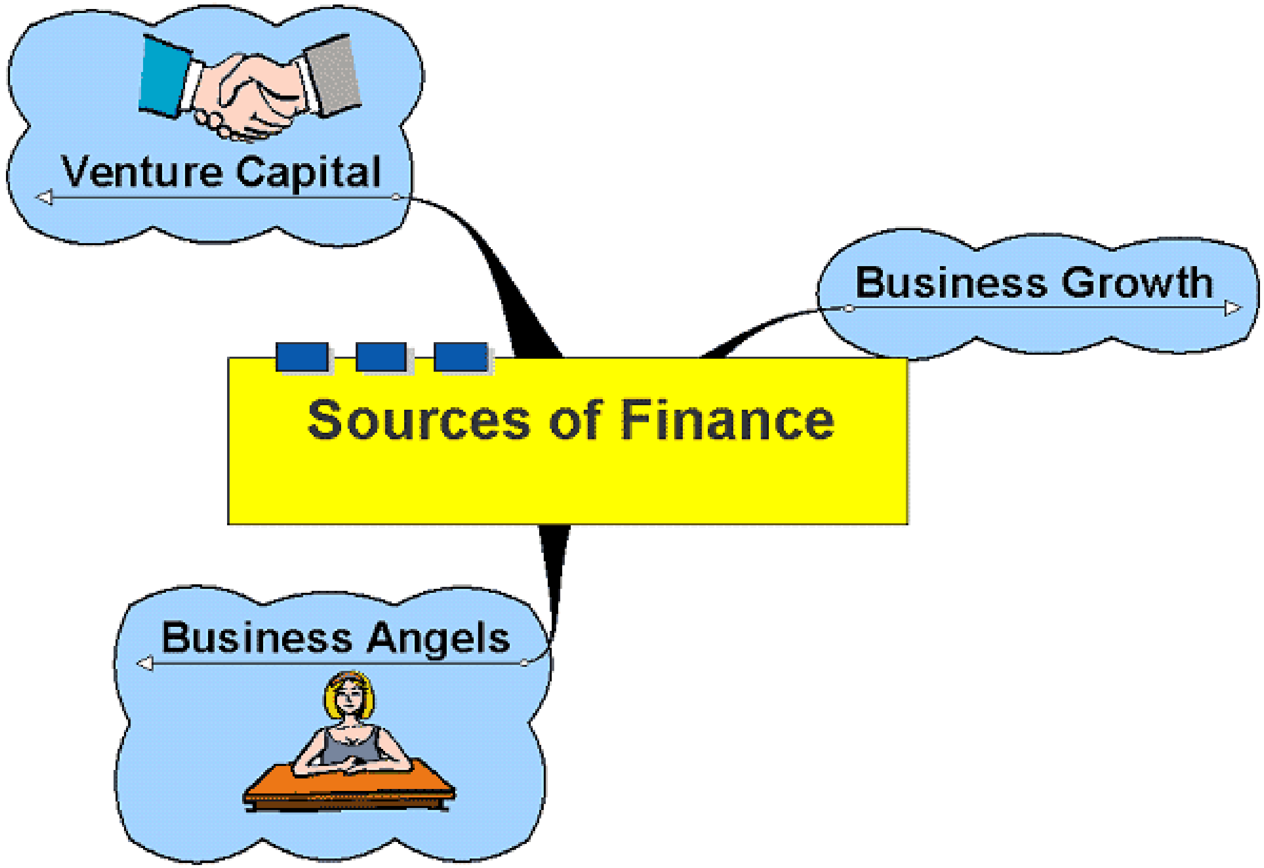
Sole Proprietorships

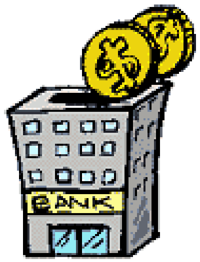
Partnerships

Corporations

Hybrids

Sources of Finance





Business Growth
External

- Long Term
- Short Term
- 'Inorganic Growth`

Business Growth External

- Long Term
  - Shares
    - Ordinary Shares
    - Preference Shares
    - New share issues
    - Rights Issue
    - Bonus or Scrip Issue
  - Loans
    - Debentures
    - Bank loans (mortgage)
    - Merchant or Investment Banks
    - Government/EU
      - Grants

Business Growth External

- Short Term
  - Bank loans
  - Overdraft facilities
  - Trade credit
  - Factoring
  - Invoice discounting
  - Leasing

Business Growth
External

- 'Inorganic Growth'
  - Acquisitions
    - Merger
    - Takeover

External Sources of Finance

- Long Term – may be paid back after many years or not at all!
- Short Term – used to cover fluctuations in cash flow
- ‘Inorganic Growth’ – growth generated by acquisition

Long term (Means?)

- Loans (Represent creditors to the company – not owners)
  - **Bank loans and mortgages** – suitable for small to medium sized firms where property or some other asset acts as security for the loan
    - A *mortgage loan* is a loan secured by real property
  - **Merchant or Investment Banks** – act on behalf of clients to organise and underwrite raising finance
  - **Government/EU** – may offer loans in certain circumstances
    - Grants
- Shares (Shareholders are part owners of a company only in PLC's)
  - **New Share Issues** – arranged by investment banks.

Short Term

- **Bank loans** – necessity of paying interest on the payment, repayment periods from 1 year upwards but generally no longer than 5 or 10 years at most
- **Overdraft facilities** – the right to be able to withdraw funds you do not currently have
  - Provides flexibility for a firm
  - Interest only paid on the amount overdrawn
  - Overdraft limit – the maximum amount allowed to be drawn - the firm does not have to use all of this limit
- **Trade credit** – Careful management of trade credit can help ease cash flow – usually between 28 and 90 days to pay
- **Factoring** – the sale of debt to a specialist firm who secures payment and charges a commission for the service.
- **Leasing** – provides the opportunity to secure the use of capital without ownership – effectively a hire agreement

thanks