Sources of Finance

Ways in which businesses access finance to pay for assets and running costs.

Own Funds: Using money the owner has saved.
+ No cost to the finance / - Risk
Family and Friends: Borrowing from friends and family is a popular source of external finance for many new entrepreneurs.
+Flexible repayments / - Can cause family arguments
Additional Partners: Adding an additional partner to the business who will be required to invest.
+ Shared liability / - Dilutes ownership
Reinvesting Profits: Using profit earned from the previous year.
+ No cost (i.e. Interest) / - Upset shareholders
Sale of Assets: Selling assets that are no longer needed.
+ Reduce wastage / - Can't produce as much
Share Issue (PLCs): Selling shares to investors on the Stock Exchange.
+ Quick investment / - Risk of takeover
Bank Loan: Borrowing a lump sum of money from the bank.
+ Flexible how used / - Interest to be paid
Overdraft: Where a bank allows a firm to take out more money than it has in its bank account.
+ Easy to arrange / - Interest usually high
Hire Purchase: When a business pays for assets in monthly instalments, until paid in full.
+ Reduces cash flow issues of a large purchase / - Pay more for the asset than it is worth

Sources of Finance

Leasing: When a business 'rents' equipment.
+ Reduces cash flow issues of a large purchase / - Never own the asset - hired
Trade Credit: Delaying payments to suppliers / business that money is owed.
+ Delay payments – good for cash flow /
- Reliant on a good relationship with suppliers
Venture Capital: An investor who offers finance and expertise in return for a share of the business.
+ Expertise as well as finance / - Lose control
Business Angels: Business angels are similar to venture capitalists, however, they focus on new businesses and take more of an advisory role.
+Receive constant advice / - can cause disagreements

Government Grants: Money given to businesses for specific purposes e.g. for setting up in a deprived area.
+ No need to repay / - Lots of paperwork

Key Terms
Cost: Does interest need to be paid?
Capital: Another word for equipment
Long Term: Paid over more than one year
Short Term: Paid in under a year
Liability: Responsibility for the debt
Internal sources – internal sources are sources of money from within the business, from the owner, or from previous business income (earned through profit)
External sources – external sources are sources of money from outside the business, from other people putting money into the business.

Revenue and Costs

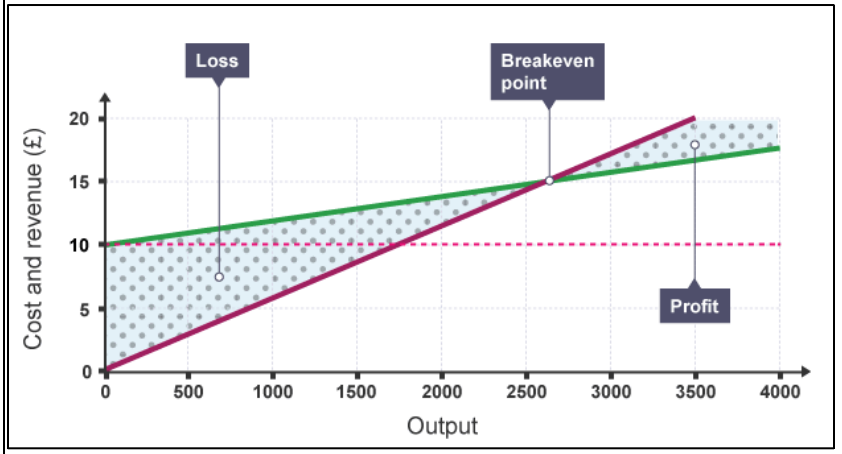
Key Term	Definition/Formula
Revenue	**is the money or income a business receives from selling its products or services.**
Revenue	**number of products sold x price of product**
Costs	**This is the money that businesses spend to operate the business. A business will have many costs to pay in order to run the business.**
Fixed Costs	**costs that do not change with an increase or a decrease in the amount of goods or services produced or sold**
Variable Costs	**costs that vary with the level of output.**
Total Costs	**fixed costs + Variable costs**
Profit/Loss	**revenue > costs equals profit** **revenue < costs equals loss**
Profit/Loss	**revenue – total costs**

Break-Even

This is the point at which the business makes neither a profit nor a loss.

Total Revenue = Total Cost

Breakeven = Fixed Costs / (Selling Price – Variable Cost)



A Lower Breakeven Point is usually better – less products have to be sold in order for a business to cover its costs.

Improving Breakeven: Increase Revenue per unit / Reduce Fixed Costs / Reduce Variable Costs

Cash Flow

Cash Flow Forecast: shows the **prediction** of the flow of cash (money), in and out of a business, by comparing **inflows** and **outflows**.

NET CASH FLOW = INFLOWS – OUTFLOWS

OPENING BALANCE

CASH INFLOWS
CASH OUTFLOWS
NET CASH FLOW

CLOSING BALANCE

Opening balance: The money available at the beginning of the month (The closing balance of the previous month).
Cash Inflows: cash flowing into the business (revenue, loan, selling assets)
Cash Outflows: cash flowing out of the business (wages, materials, electricity)
Net cash flow = Total Revenue – Total Expenses.
Closing balance The money available at the end of the month. Calculation = Net Cash Flow + Opening Balance

Ways to Improve Cash Flow…

Increasing Revenue:	Reducing Outflow:
- Increase Price - Reduce Price - Advertise - Etc…	- New Suppliers - New premises - Reduce wages - Etc…

Profit and Loss

Profit and Loss: shows the annual (yearly) levels of profit or loss.

Revenue: Money that comes into the business through sales - AKA: Income, Sales Revenue, Turnover

Cost of Sales: Costs directly linked to the production of products
e.g. Raw Materials.

Expenses: Costs that are indirectly linked to the production of products.
e.g. Rent, salaries, petrol.

Gross Profit: The amount of revenue that is left, once cost of sales have been taken into account.

GROSS PROFIT = Revenue – Cost of Sales

Gross % Profit: The % of revenue that is gross profit. E.g. 25%, would mean that 25p of every £1 of sales revenue would be GROSS PROFIT.

GROSS % PROFIT = $\frac{\text{Gross Profit}}{\text{Revenue}} \times 100$

Net Profit: The amount of revenue that is left, once all costs and expenses have been taken into account.

NET PROFIT = Gross Profit - Expenses

Net % Profit: The % of revenue that is gross profit. E.g. 10%, would mean that 10p of every £1 of sales revenue would be NET PROFIT.

NET % PROFIT = $\frac{\text{Net Profit}}{\text{Revenue}} \times 100$

Improving Profitability	
Increase revenue: • **Increase price** • **Reduce price** • **Increase quality** • **Sell in more countries** • **Extend product range**	**Reduce costs:** • **Cheaper suppliers** • **Change location** • **Reduce salaries** • **Reduce amount of workers**