

90. Sources of Finance

I. Missing words

Most companies raise most of their finance from within their own resources, i.e. _____ finance such as trading profit. About 60% of all finance for expansion comes from this source. Sometimes, though, there are such attractive growth opportunities that managers are unwilling to wait for internal finance to accumulate. Therefore _____ sources are approached, such as loans or equity, i.e. _____ capital. Injections of capital from outside have financed many of Virgin's projects, such as Virgin Rail. (words from: share, internal, external)

2. Internal or external? Put the sources into the correct column:

Bank loans, venture capital, asset sales, share capital, profit, cutting costs, cutting stocks, leasing

Internal sources of capital	External sources of capital
1.	1.
2.	2.
3.	3.
4.	4.

3. Explain why:

3.1 A firm may choose to take a bank loan rather than an overdraft. _____

3.2 A firm cannot 'use' its reserves as a source of finance _____

4. Match the source to the need (identify 2 sources for each of the requirements 1-5)

Exam hint: the type of finance must be appropriate to its use; for instance, a short-term, seasonal dip in cash flow can be met by an overdraft, whereas a debenture is better suited to financing the purchase of property.

Business requirement for finance	Source of finance	Source of finance
1. To cover trading losses during a recession	A. Overdraft	V. Reinvested profit
2. For replacing 1,000 computers on an ageing network	B. 2 - 5 year bank loan	W. 25 year debenture
3. To finance a major expansion overseas	C. Rights issue to raise extra share capital	X. Extended credit from supplier
4. To finance rapid sales increases for a small firm	D. Credit factoring	Y. Venture capital
5. To finance the purchase of an office block	E. Sale and leaseback	Z. Selling under-used fixed assets

90. ANSWERS - Sources of Finance

1. internal ... external ... share

2.

Internal sources of capital	External sources of capital
cutting costs	Bank loans
asset sales	venture capital
Profit	share capital
Cutting stocks	leasing

3. Explain why:

3.1 A firm may choose to take a bank loan rather than an overdraft.

If they need the money on a medium to long term basis. The interest on an overdraft is higher so it may prove cheaper to take a loan.

3.2 A firm cannot 'use' its reserves as a source of finance

Reserves are the total previous profit made by a firm – they are not cash which can be spent. In fact, they have probably already been spent

4. Match the source to the need (identify 2 sources for each of the requirements 1-5)

Business requirement for finance	Source of finance
To cover trading losses during a recession	Z, A, C
For replacing 1,000 computers on an ageing network	B, V or Z
To finance a major expansion overseas	C, E, V or Y
To finance rapid sales increases for a small firm	C, D, E, X or Y
To finance the purchase of an office block	C, E, V or W