Chapter 25 External finance

Key terms

1. External finance: finance from source outside of the business
2. Leasing : a contract through which a business acquire the use of resources e.g. property , machine or equipment.
3. Loans: a loan is an arrangement where the amount borrowed must be returned over a fixed period of time. Interest rate can be charged.
4. Unsecured loans : the lender has no protection if the borrower fails to repay the money owned. It can be short term or long term.
5. Secured loans : where the borrower has to provide some assets as collateral to support the loan. If the borrower defaults, lender can sell assets and use the money to repay outstanding amount.
6. Debentures : The holder of a debenture is creditor. Debenture holders are not the owner, they cannot vote. They get fixed return.
7. Bank overdraft: that a business can spend more money than it has in its account.
8. Capital gain: the profit made from selling a share for more than it was bought.
9. Crowd funding: where a large number of individuals invest in a business or project on the internet, avoiding the use of a bank.
10. Equities: another name of ordinary share.
11. Peer to peer lending(P2PL): where individuals lend to other individuals without prior knowledge of them, on the internet.
12. Venture capitalists: provides of funs for small or medium sided companies that may be considered too risky for other investors.
13. Share capital: the money raised from the sales of shares.

1. **External finance**

External finance : finance from source outside of the business

Sources of External finance

Sources of External finance	Advantages	Disadvantages
1. Family and friends	• Cheap source of funds	• It can breakdown relationship with friends and family, if the money cannot be repaid.
2. Bank loan (overdraft and mortgage)	• Banks may offer advisory services to business	• It has interest charged on loans. • It may require business plan and financial document.
3. Peer to peer lending	• Transactions are undertaken online.	• All loans are unsecured(no protection on lender)
4. Business angles	• Lenders who like taking risk can be a part of a new business.	• Profits need to be shared to angles.
5. Crowd funding	• Business owners can publish details of business projects to seek for finance. • Investors can invest just a little money to get share in the business.	• It cannot guarantee that the fund is enough for investment.
6. Other business financed is provided by other businesses	• Some businesses set up joint ventures, sharing finance cost and profit.	• A public limited company might buy shares in other companies to build a controlling stake or for taking over the business.

2. Methods of finance

1. Loans ; a loan is an arrangement where the amount borrowed must be returned over a fixed period of time. Interest rate can be charged.

1.1) Bank loans

- Unsecured loans : the lender has no protection if the borrower fails to repay the money owned. It can be short term or long term.

1.2) Mortgage

- Secured loans : where the borrower has to provide some assets as collateral to support the loan. If the borrower defaults, lender can sell assets and use the money to repay outstanding amount.

1.3) Debentures : The holder of a debenture is creditor. Debenture holders are not the owner. They cannot vote and get fixed return.

2. Share capital

- Issued share capital; the money raised from the sales of shares.
- Authorised share capital; the maximum amount shareholders want to raise share capital is often referred to as permanent capital.

3. Venture capital

- Provides of funs for small or medium sided companies that may be considered too risky for other investors.

4. Bank overdraft

- Bank overdraft means that a business can spend more money than it has in its account.
- The bank and the business will agree on an overdraft limit and interest
- It is only charged when the account is overdrawn.

5. Leasing : a contract through which a business acquire the use of resources e.g. property , machine or equipment.

6. Trade credit : to buy naw materials, components and fuel and pay them at a later date, usually within 30-90 days.

7. Grants : paid by government to producers