**Sources of Finance**

**Total Finance**

- **Long Term**
  - Ord Shares
  - Pref Shares
  - Loans & Debens
  - Leases

- **Short Term**
  - Bank O/D
  - Debt Factoring
  - Invoice Discount

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**Long-term Sources of Finance**

- Long-term sources - those repayable beyond 1 year.

**Ordinary Shares**

- The risk capital of a company.
- No guaranteed return, but potential is unlimited.
- High risks require a high rate of return.
- No tax relief (company) on paying dividends.
Long-term Sources of Finance

Preference Shares

- A lower level of risk than ordinary shares.
- Documents of incorporation determine the precise rights of preference shareholders.
- Lower return generally due to lower risk.
- Cumulative, non-cumulative, participating, redeemable.
- Not used extensively because of tax implications.

Issuing Shares

Rights Issue

- Offer existing shareholders the right to acquire new shares in exchange for cash.
- Proportionally allocated.
- Often offered at lower than market value.
- Very common - low expenses.
- The investment already suits the risk/return requirements of investors.
## Long-term Sources of Finance

### Bonus Issue

- Involves the issue of new shares to existing shareholders proportionally.
- Effected by transferring a sum from reserves into paid-up share capital, and issuing shares equivalent to the amount transferred.
- Reduces the reserves available for dividend.
- **Reasons for enacting a bonus issue include:**
  - Stabilising or reducing share price.
  - Lender confidence (by increasing permanent capital).
  - Market Signals
  - As an alternative to a dividend.

### Offer for Sale

- **EG:** A PLC selling a new issue of shares to an issuing house (financial institution).
- Advantage to the company is that sale proceeds from the issue are certain (issuing house assumes the risk).
- Typical of a company seeking a SE listing.

### Public Issue

- Company makes a direct invitation to the public to purchase shares in the company. (Newspaper ad)
- Issuing house may be involved in helping to set initial price.
Long-term Sources of Finance

Placing

- Instead of a public issue, shares are "placed" with selected investors, eg: a bank.
- Can be quicker and cheaper.
- Avoid concentrating ownership of the company in just a few hands.

Loans and Debentures

- Many companies rely on loan capital for finance. Contract entered into specifying rate of interest, date of interest and capital repayments, term, security for loan etc…
- Convertible loans to reduce lenders risk.
- Loan covenants allow the lender to impose certain obligations and restrictions on the borrower.
- Interest payments are tax deductible.
**Long-term Sources of Finance**

**Finance Leases**

- Essentially another type of loan.
- Financial institution buys an asset and then leases it to the company.
- Ownership remains with the lessor (fin inst), but risks and rewards are associated with the lessee.
- Easy to obtain, moderately cost effective, flexible, good for cash flow.
- Not tax efficient.

**Short-term Sources of Finance**

- Short-term sources of finance are those repayable within 1 year.

**Bank Overdraft**

- A flexible form of borrowing (subject to bank agreement).
- Bank may require forecasts or security.
- Repayable on demand however.
Short-term Sources of Finance

Debt Factoring

- A service offered by some financial institutions (factors).
- Factor assumes responsibility for debt collection.
- The factor may make an advance to the company of 80% - 85% approved trade debtors.
- Rate charged by a factor tends to be similar to that charged on overdrafts.
- Highly convenient in certain circumstances.
- May have an adverse affect on confidence in the company.

Invoice Discounting

- Involves a company approaching a financial institution for a loan based on a proportion of the face value of outstanding credit sales.
- Responsibility for collection remains with the business.
- A more important source of funds than factoring because it is cheaper and more confidential.