2.11

Using Skills for a Business

Financial Planning for a business

Learning Outcome Notes

LO 2.8 - Devise and apply a marketing mix in order to promote a new or existing product or service

CHAPTER QUESTIONS

By the end of this learning outcome you should be able to answer the following questions

1. Understand the different financial needs of a business
2. Explain the different types of short, medium and long term source of finance
3. Describe the factors a bank considers before given a loan
4. Define the term working capital
5. Prepare ad Analysis a cash flow forecast

FINANICAL NEEDS OF BUSINESSES

Short Term needs

These are needs that must be repaid within 12 months (0-12 Months). Examples include Wages, Insurance Rent. They are usually current expenditure. Current expenditure is day to day expenditure.

Medium Term Needs

These are needs that must be repaid within 1-5 years. Examples include buying vehicles. They are usually capital expenditure. Capital expenditure is once off expenditure.

Long Term Needs

These are needs that must be repaid within over 5 years. Examples include buying premises. They are usually capital expenditure.

Matching principal

The matching principal states that the short, medium and long term needs should match the short, medium and long term source finance

FACTOR THAT AFFECT THE CHOICE OF AOURCE OF FINANCE

1. **The purpose of the finance** – What is the finance needs for (what is he need). It is short term, medium term or long term
2. **The amount of finance required** – How much do you need. It is important not to get too much because you will have to pay back interest, and this is expensive

3. **Cost of Finance -** This is known as the financial Cost. The company should compare the APR of different financial institution and select the best rate (The cheapest Rate)
4. **Control** – will the company lose control of their business – for example if they sell share they will give a bit of the company to the share holder
5. **Security** – will the company have to give Collateral in case of them not paying back the debt. This is given the financial institution a fixed asset that they can sell to pay the debt is the company can't repay the loan

SOURCE OF FINANCE

Debt Finance — Def This is money that is borrowed that has to be repaid with interest

Equity Finance — Def This is money that is usually got from selling shares. It is the owners capital

SHORT TERM SOURCE OF FINANCE

The following are examples of short-term sources of Finance

Cash — Def Using the cash the company has to pay debt.

Bank overdraft — Def This is an agreement with the bank to withdraw money that you don't have in your current account up to a certain limit. You pay interest on the overdrawn amount

Accrued Expenses — Def This is also known as deferred payment. You don't pay a bill when you get it but leave it to the last minute. It can affect you credit rating.

Trade Credit — Def This means buying now paying for them at a later date. If you pay before the date, you will receive a discount. Interest can be charge on overdrawn amounts

Credit Card — Def This is buying now and paying for them at a later date. The credit card company will pay for the purchase, and you will pay the credit card company back with interest. It is not good for all purchase and can be very expensive

Invoice Discounting Def This is borrowing money based on payment from an invoice. The business will collect payment and will use this to repay the loan. Interest can be charge on overdrawn amounts

Factoring Def This is when a business sells a debt to a factoring company for less value of the amount owed. They used this money to pay bill and the factoring company will get the full value from the debtor

MEDIUM-TERM SOURCE OF FINANCE

Leasing Def This is renting an asset form a company. It allows the company to use the asset as long as they pay regular payments. It is a legally binding agreement.

This type of finance is expensive as you never own the asset. No Security is required as the Assets always belongs to the leasing company

Hire Purchase Def This is when the business pays a deposit for an asset, then a finance company pays the balance. The business pays back the finance company with interest. The business doesn't own the asset until the last instalment is paid

This is a very expensive form of finance as the ARP can be as much as 20%. If the business doesn't pay an instalment they can lose the asset

Medium Term Loan Def This is usually a loan from a financial institution. The business swill make fixed repayment to the financial institution until the loan is repaid. This repayment includes the interest plus the loan repayment amount)

APR is usually cheaper but if the loan is not repaid the business credit rating can be affected. Security may be needs to get the loan

LONG TERM SOURCE OF FINANCE

Share capital Def This is money that is invested into the business by its shareholders. In return for this they will receive a dividend.

There is no fixed interest payment but issuing new share will reduce the control of other shareholders

Venture capital Def This is like dragons' den. They invest in new or high-risk business.
They will sit on the board of directors and help plan a strategy for the business to follow
The investors will look for a high return on their investment. The business may need to give some control to the investor in the form of shares

Retained Earnings Def This is when the business puts the profits from the year back into the business.
This is a form of equity finance. There are no interest repayment or loss of control

Grants Def This is money given by the Government to a specific purpose.
There is no interest charged as long as the money is used for the intended purpose.

Sale and Lease back Def This is when a business sell their premises to raise finance but will then lease (rent) it back from the buyer
This will result in the business spaying a fixed rent and will lose control over the asset

Debentures Def This is s long term loan that has to be paid back a specific date in the future.
They will have to pay back interest each year. There is no loss of control, but security will be Required

Mortgage Def This is s loan that is used to purchase a premise. IT is usually paid back between 25-30 years
If the business can't repay the mortgage, they may loss the premises. The business may not be able to sell the premises within that period if they need finance. They will need to give some form of security

Crowdfunding Def This is asking investors for small amount of money for which they will receive a reward
It can be hard to raise a lot of finance this way. A share of the profits may be given to the Investors but there is no security required

LOAN APPLICATION FOR A BUSIENSS

The following are some of the factors a bank will consider before given a loan

1. The purpose of the loan – What does the business require the loan for. Will the loan help the business to be in a better position
2. Can the business repay it – The bank will look for several year bank statement and for the business to prove they can afford the repayments
3. A Business Plan – This will set out the vision for the business and help the bank understand the future projection of the business for sales, expenditure and profits
4. Collateral – A bank may require some form of security. This will be sold if the business fails to repay the loan
5. Credit History – The bank will make a credit check on the business to see if they had god out previous loans and if they were repaid
6. Own Investment – The banks like to see the business put up some of the money themselves. This measn the business will share the risk.

WORKIGN CAPITAL MANAGEMENT AND CASH FLOW FORECASTS

Working Capital [Def] This is the money that a business uses for the day-to-day running of a business

Working capital is calculate by using the following formula - Current Assets – Current Liabilities

Liquidity [Def] This is the business ability to repay debts as they fall due. It is about cashflow and if the business can pay its day-to-day expenses.

The business needs to have cash to survive. Have poor liquidity means the business scant repays It debts and expenses so is at danger of going bankrupt. One reason for having poor liquidity is growing the business to fast, given too much credit and not colleting the money in time

THE BUSIESS OPERATING CYCLE

Manage Debtors

Debtors [Def] These are the customer who owe use money. We have sold goods to them on credit

When a business sells goods on credit, they give the buyer 30 days to pay for the goods. This means

that the business will not receive money for 30 days sometimes it can be longer. It is important that the business receives payment regularly from debtors so they can buy raw materials and pay expenses

Managing Stock

Stock Def This is making sure that the business has the optimum level of stock. This is not having to little or too much stock.

If the business has too little stock, they will lose out on sales and the potential of customer Loyalty as they will go somewhere else to get the product, they need.

Managing Cash Flow

Cashflow Def This is like a household budget but for a business. It shows the expected monthly income and expenditure. It helps to identify future surplus and deficits

CASH FLOW FORECASTS

There are two parts to the Cashflow forecast – 1. Receipts (Income) and 2. Payments (Expenditure)

The following are examples of receipts and payments for a business

Income	Expenditure
Sale income	Purchases
Receipts for debtors	Dividends
Income from grants	Taxation
Borrowings	Payment to creditors