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Sources of finance

One of the first principles of business is: all businesses need funds in one form or another in order to succeed. It is obvious, therefore, that successful businesses have to be good at finding sources of finance. So, what are these sources?

First, we need to distinguish between internal and external sources. From an internal point of view, a company could use its profits, or sell off some of its assets, or reduce its stock inventory, and all of these would help to raise finance. Even so, these finance methods are often not sufficient, so most companies probably have to raise money externally as well. This happens in a variety of ways: small businesses may borrow from friends or family, or else get a loan or an overdraft from a bank. In some circumstances, it is possible to get financial help or a start-up loan from the government. For bigger companies, external methods might involve raising share capital or loan capital from a bank or other lender.

In addition, sources of finance can be divided into short-, medium- and long-term borrowing. Palmerstone et al. (2018) define these as follows: 'Short-term refers to day-to-day requirements, medium-term is usually one to five years, long-term is more than five years.' (p. 26). Trade credit from suppliers, government start-up loans and bank overdrafts are usually thought of as short-term, while medium-term borrowing methods include the leasing or hire purchase of equipment. Long-term finance depends on the size and success of the company and might comprise share issues or further loan capital such as a mortgage. Short-term capital needs to be repaid over a short period, whereas long-term capital, which a company needs in order to expand, will normally be paid back over a number of years.

Let's look at some examples. James Cooper decided to open a vegetarian café by the sea in the south-west of England. He had studied business at college and had several years' experience working in restaurants. In order to start the business, he needed capital. He had a personal loan of £5,000 from his mother. As Grange (2017) asserts: '... for small businesses trying to get started, use of family resources is quite common' (p. 120). However, James needed at least £30,000, so he approached his bank, which was only willing to give him a loan for £10,000. James was unsure what else he could do. For many new entrepreneurs it appears to be the case that raising finance is 'one of the most difficult problems they have to face' (Brookes, 2016, p. 10).

Then James remembered something he had read about in college: angel investors. These are rich people who will give money to business start-ups if they think they will get a good return on their investment. In addition, several writers have suggested that angel investors may provide valuable advice for small business owners (e.g., Brookes, op. cit.), but there are risks on both sides. It is sometimes said that over half of new businesses fail in their first year. However, the evidence does not support this belief. In fact, recent research has shown that the figure for new business failures is closer to 20% (Young, 2023). Fortunately, James was able to find an angel: he went on to start his business, and after five years he was making a healthy profit. Thus, as the data indicate, James' experience was not unusual.

Even very large companies nearly always start out small, as can be seen in Walmart's astonishing development from an insignificant cut-price chain store business in the southern USA to gigantic global retailer. Ortega (2000) described how Sam Walton, the founder, and his wife had to scrape the money together themselves for their first Walmart store in the 1960s. Later, Walton could only obtain enough funds to build 15 Walmart stores. By 1972, however, he had succeeded in having Walmart listed on the New York Stock Exchange. With the capital raised, the business expanded to 276 stores by the end of the decade, and in 1997, the first \$100 billion sales figure was reached. In 2019, Walmart boasted a revenue of over \$514.4 billion (Walmart, 2019).

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