Internal financing definition

This happens when **a company uses its own profits as a source of capital for a new investment** rather than getting the money from outside sources.

A source or sources of finance, refer to where a business gets money from to fund their business activities. A business can gain finance from either **internal** or **external** sources.

Internal sources of finance

Internal sources of finance refer to money that comes from within a business..

Owners capital refers to money invested by the owner of a business. This often comes from their personal savings. Personal savings is money that has been saved up by an *entrepreneur*.

Retained profit is when a business makes a profit, it can leave some or all of this money in the business and reinvest it in order to expand. This source of finance does not incur interest charges or require the payment of dividends, which can make it a desirable source of finance.

Selling assets involves selling products owned by the business. This may be used when either a business no longer has a use for the product or they need to raise money quickly. Business assets that can be sold include for example, machinery, equipment, and excess stock.

External sources of finance

External sources of finance refer to money that comes from outside a corporation.

Family and friends - businesses can obtain a loan or be given money from family or friends that may not need to be paid back or are paid back with little or no interest charges.

A **bank loan** is money borrowed from a bank by an individual or business. A bank loan is paid off with *interest* over an agreed period of time, often over several years.

Overdrafts - are where a business or person uses more money than they have in a bank account. This means the balance is in minus figures, so the bank is owed money. Overdrafts should be used carefully and only in emergencies as they can become expensive due to the high interest rates charged by banks.

Venture capital - refers to an individual or group that is willing to invest money into a new or growing business in exchange for an agreed share of the profits.

New partners - is when an additional person or people are brought into the corporate as a new business partner. This means they would provide money to then own part of the business.

Share issue - a business may sell more of their ordinary *shares* to raise money. Buying shares gives the buyer part ownership of the business and therefore certain rights, such as the right to vote on changes to the business.

A **trade credit** must be agreed with a supplier and forms a *credit agreement* with them. This source of finance allows a business to obtain raw materials and stock but pay for them at a later date. The payment is usually made once the business has had an opportunity to convert the raw materials and stock into products, sell them to its own customers, and receive payment.

Leasing - is a way of renting an asset that the business requires, such as a coffee machine. Monthly payments are made and the leasing company is responsible for the provision and upkeep of the leased item.

Hire purchase - is used to purchase an asset, such as a delivery van or piece of equipment. A deposit is paid and the remaining amount for the asset is paid in monthly instalments over a set period of time.

Government grants - are a fixed amount of money awarded by the government. Grants are given to a business on the condition that they meet certain criteria such as providing jobs in areas of high unemployment.