Unit 2: Managing Financial Resources & Decisions

Assignment 1: Sources of finance and its implications

1. As a start-up, there are a range of sources of finance available for Sonia's and Kate's catering business. However, there won't be as many available to those who have larger businesses. One of the most popular sources of finance would be to use savings or personally invest via other means, such as any inheritance received or a pay-out. This would mean you would have 100% control of your business, although you may not have enough to cover for machinery or property. You could ask family and friends to lend you money which could work out cheaper than borrowing through a bank or any other types of lending facilities, as you may be able to borrow for longer and rates may be much lower. This could come with some complications such as they may want to be involved in the day to day running of the business or tensions could arise if the business isn't doing as well as expected.

There are also a large range of government schemes and local funding finance sources you can obtain. What is available is dependent on the area you live in and more support is usually given to those living in high unemployment areas. The government scheme offers a scheme called 'Start Up Loans'. "Start Up Loans is a government-backed scheme helping individuals start or grow a business in the UK. Alongside the low-interest loan successful applicants can access free mentoring from experienced advisors." (Start Up Loans, 2016) These schemes are really beneficial for those that are setting up businesses for the very first time. As with a bank "You will need to provide a business plan, cash flow forecast and personal survival budget with your application." (Start Up Loans, 2016) Interest rates are usually lower than banks, however if you are unable to provide an effective business plan finance may not be obtainable.

A bank loan would be another source of finance. Banks would typically only lend if the business has any assets including the business owners' personal assets. Banks would only usually tend to lend on a matching stake principal where they will lend the amount the business owner(s) have invested into their business. In this scenario, Sonia and Kate would only most likely be able to borrow £1500 as this was what has been invested into the business. A business plan would also need to be provided which clearly shows the businesses potential along with risks. Barclays for example request the following information "Your trading accounts, business plan and details on profits and losses. Information on what you're planning to use the loan for including whether security is needed". (Barclays, 2016)

A bank overdraft is a source of finance available. Bank overdrafts are useful for managing cashflow and is a short-term solution "Overdrafts are repayable on demand and typically reviewed annually". (Barclays, 2016) Interest is also charged daily whilst overdrawn. This source of finance wouldn't be best suited for Sonia and Katie as it wouldn't be deemed by the bank as a good use of an overdraft due to how long it could take them to pay back and can be demanded to be paid back at any time, which could cause cashflow problems and further bank charges.

A bank credit card could be an option, again this is a short-term solution as interest is charged usually after 45 days from the original date of purchase. Some banks such as RBS offer this and claim "Maximum 45 days for purchases if you pay your balance in full and on time. No interest-free period on balance transfers and Cash Advances." (Royal Bank of Scotland, 2016). Credit cards are usually used for day to day expenses or for purchases they don't have the cash for but can pay back within a short period of time. As the cost of the van is £8500 a credit card would not be the best solution due

to interest rates being quite high, typically around 16.9% APR. The best use of a credit card is usually for purchases such as fuel, travel expenses, hotels and entertainment.

Borrowing through banks can be a difficult source of finance to obtain especially if your business is just starting up, there are other finance options available, such as Hire Purchase or Lease Purchase. Accounting standards define hire purchase as "a contract for the hire of an asset that contains a provision giving the hirer an option to acquire legal title to the asset upon fulfilment of certain conditions stated in the contract" (Low Cost Vans, 2016). After the instalments, have been made you are given the option to buy the van at a significantly reduced cost. This is a simple way of obtaining finance for a required asset and you can obtain capital allowances when paying corporation tax. The disadvantage of this sort of finance is that the VAT must be paid upfront and you retain the residual value risk. This could be an option for Delicious, especially if they are facing issues with borrowing from a bank as these types of finance are usually easier to obtain.

Lease Purchase is useful for when you don't have the money upfront to purchase and are definitely wanting to own at the end of the lease agreement. "The monthly cost is worked out on the difference between the retail value and the depreciation value plus interest." (Low Cost Vans, 2016). Monthly repayments are usually low which is ideal for businesses just starting up and don't want high outgoing costs. The vehicle is classed an asset which you can record the value against any taxable profits. The disadvantages are that at the end of the agreement you need to pay the balloon payment in full before you own the vehicle. This can sometimes work out to be higher than the residual value. This option is probably the best out of all sources of finance for Delicious. Low monthly payments will ensure their monthly outgoings are not too high at the beginning of their business. Delicious would however, need to ensure that they have funds available at the end of their contract to purchase the van.

Due to Sonia and Kate only having £1500 capital, the best option would be to obtain the van via a Lease Purchase. They have money to put towards the van and can take advantage of the low monthly cost with the knowledge that they will own the vehicle at the end of the contract. Another advantage is that these companies offer free or discounted service options and extended warranties.

2.1

Loans				Total Interest			Monthly Repayments		
Ref	Finance Source	Typical Interest Rate	Amount	24 Months	36 Months	60 Months	24 Months	36 Months	60 Months
1	Barclays	8%-20% (Using 14%)	£ 8,500	£ 1,295	£ 1,958	£ 3,367	£ 408	£ 291	£ 198
2	HSBC	5.9%-15% (Using 10%)	£ 8,500	£ 914	£ 1,374	£ 2,336	£ 392	£ 274	£ 181
3	Lloyds	2%-15% (Using 8%)	£ 8,500	£ 726	£ 1,089	£ 1,841	£ 384	£ 266	£ 172
4	Gov't Scheme Start Up Loans	6%	£ 8,500	£ 541	£ 809	£ 1,360	£ 377	£ 259	£ 164

Hire Purchase/Lease Purchase				Total Interest			Monthly Repayments		
Ref	Finance Source	Typical Interest Rate	Amount	24 Months	36 Months	60 Months	24 Months	36 Months	60 Months
5	Hire Purchase (Deposit of £500)	8.1%/8.17%/8.45%	£ 8,500	£ 1,295	£ 1,962	£ 3,381	£ 387	£ 277	£ 190
6	Lease Purchase (Deposit of £1.4k)	8.96%/8.21%/7.9%	£ 8,500	£ 890	£ 1,160	£ 1,720	£ 192	£ 152	£ 115
Balloon Payment (Lease Purchase)							£ 3,360	£ 2,730	£ 1,820

Ref 1 (Barclays, 2016) **Ref 2** (HSBC, 2014) **Ref 3** (Lloyds, 2016) **Ref 4** (Start Up Loans, 2016)

Ref 5 (Unison Drive, 2016) **Ref 6** (Lombard, 2016)

Sonia & Kate have two different sources of finance to borrow based on their circumstances.

Through the bank, interest rates are variable and are dependent on financial circumstances. Interest rates tend to vary from as little as 2% up to 20%. Using three major UK banks monthly repayments calculations have varied from £172 per month to £408 per month based on loan term. Total interest varied from £726 up to over £3,000 again dependant on the loan term. Having a longer loan term means lower monthly payments, however you pay far more interest than you would over a shorter period.

The government backed scheme 'Start Up Loans' has a fixed interest rate of 6% with monthly repayments starting from £377 per month to £164 per month. Total interest started from £541 over a 24-month period to £1,360 over a 5-year period. Compared to the banks this would save over £185 circa over a 24-month period and over £480 circa over a 5-year period. This would most likely be the cheapest option if they wanted to borrow via a loan as this has been specifically set up for start-up businesses.

There are two major differences between Hire Purchase and Lease Purchase costs. With Hire Purchase you can choose whether to put down a deposit, doing so does reduce the monthly cost. Typically, the interest rates are approximately around 8% across the market, resulting in the monthly payments and total interest being similar or greater than a bank loan. Through the example from 'Unison Drive', the longer contract term came with slightly increased interest rates. In order to pay less interest a greater deposit of £500 would be needed to be put down. Total interest over a 24-month period was around £1,295, which was approximately the same interest as a 'Barclays' loan with an interest rate of 14%.

Lease Purchase offers low monthly repayments, however, a deposit maybe required in order to obtain. Through 'Lombard' they require at least 20% of the total cost of van upfront. The longer the term the more favourable interest rates became. Over a 24-month period total interest was around £890 with monthly repayments at approximately £192. Compared to a Hire Purchase total monthly repayments is over £195 less and over £200 a month less than a bank loan. Over a 5-year period monthly repayments were £75 less than Hire Purchases and banks. The one major consideration to take into account is that a balloon payment is required at the end in order to purchase the vehicle. This ranged from over £3,000 over a 24-month period to just under £2,000 over a 5-year period.

2.2 As a new business financial planning is important as it forecasts the future performance of a business taking into account seasonal fluctuations, managing cashflow and highlights which months where you will have higher or lower expenditure. "The financial plan is normally prepared as part of an overall business planning process, during which goals are set and strategies are chosen to help the business grow in the upcoming year." (Hill, 2016) Goals can range from how many business contracts they want to source for the following year with a projection of sales and potential profit. This could also include what assets they may want to buy to improve productivity and efficiency of the business. The strategy could include increased marketing, longer term contracts with businesses and maintaining customer satisfaction through feedback.

Without a financial plan your business is likely to fail. Key decisions such as buying a new asset to enable you to operate your business efficiently, hiring and paying staff, paying tax and insurance,

and being able to pay your suppliers will not be able to be done effectively without adequate financial planning.

It is important for businesses to file their accounts on time. Partnership tax returns must be completed online before the 31st January following the end of tax year or 31st October following the end of tax year if filling by paper. (GOV.UK, 2016) Failure to submit accounts into HMRC can result in each partner being fined £100 for up to 3 months late, with additional penalties if any later than 3 months.

Without a financial plan, you won't be able to obtain financial support without one. (Carter, et al., 2004) states that writing a business plan improves the chances of success on a new venture. All lenders will want to see a financial forecast so they can make a decision as to whether to lend to you or offer financial assistance. Lenders will want to see a complete balance sheet, income statement and cashflow forecast in order for them to make a decision.

A financial plan can also tell you whether any marketing you have driven has increased revenue. This can also assist you with future marketing and strategic decisions. If your business suffers a sudden financial downturn and is lower than what you have forecasted, then you can increase marketing activities or focus on sales to generate revenue. If your overheads are more than expected, then you can take actions to reduce them.

Spending can also be prioritized better enabling you to decide which expenditures are more important than others. "It's a common mistake for small businesses to underestimate the ready money they need to keep their business running — a mistake that unfortunately leads many businesses to falter before they really have the chance to get up and running." (Clark, 2013).

Sales trends can also be spotted on financial plans. Some of your products may be selling better than others. Those that are not selling as well you can either increase marketing or if not beneficial stop selling the product.

In summary, "a financial plan will help you better understand your bottom line. Bringing in tons of money won't matter if your expenses are almost as high, or even higher. The key to business success is down to profit, not revenue. A financial plan can clearly document net profit, and help you identify ways in which you can increase it." (Clark, 2013) Keeping on top of your financial plan is also important as the market is consistently changing. (Nobel, 2011) also, agreed that "Start-ups often fail because founders and investors neglect to look before they leap, surging forward with plans without taking the time to realize that the base assumption of the business plan is wrong." Competitors will always want a bite of businesses market shares, it is how businesses respond and how quickly they react to these sudden changes that determines the success of its future.

2.3

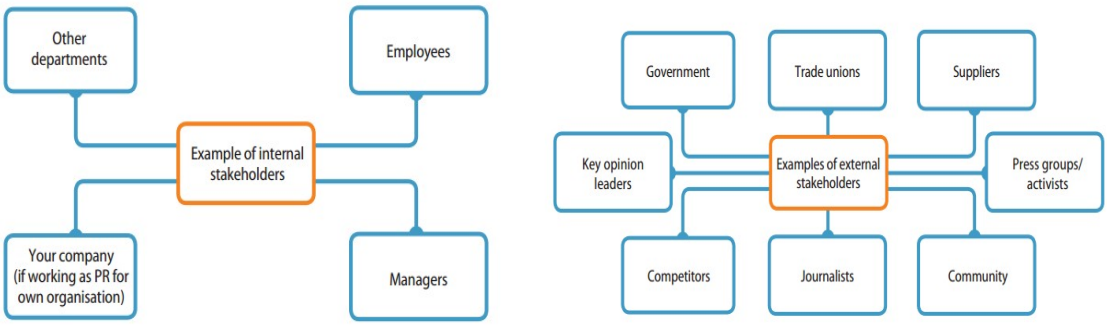

Fig.1 (Pearson, 2016)

There are several different stakeholders or decision makers who will be involved in the business that would be interested in the finances of the business. Internally a stakeholder would be the business owners themselves. A business owner would not want to go into a partnership with someone who has had financial difficulties recently, who is not financially responsible or someone who doesn't have honesty and integrity. All parties of the partnership will want to be able to make financial decisions and should all have the same goal to generate profits.

Connected stakeholders such as the golf club may be interested in the businesses finances, especially at point of negotiation of using their kitchen. The golf club will want to ensure that rent will be paid and that any assets will be looked after and maintained without bringing the club into disrepute. The golf club is also a business who rely on income from others. If they were to bring in a business who operates badly, then this could affect their business in the future.

The business partners' spouses and dependents may also want to take an interest in the businesses finances as the business performance will impact their daily living. If a loan has been taken out and secured against their home, then the spouse will be keen to know whether their home is at risk of being repossessed especially when dependents are involved.

Customers are also classed as stakeholders and their interests will be the quality of products versus the price they are paying for the goods they buy. Customers have a direct influence over the businesses finances as without them no revenue will be generated, resulting in the business failing.

Suppliers who supply the products needed for the business to sell or who provide the assets to run the business, will be interested in the businesses finances. This is so they can make a decision on payment terms such as how much credit to give the business and whether they can make the payments on time within timescales agreed. Not knowing the financial position of the business could result in goods supplied not being paid for and maybe recovery and legal costs.

External stakeholders such as HMRC will want to know how much income and expenditure the business is making. This is so they can tax them the correct amount when the business processes their tax returns. In order to open an account the bank will want to know the businesses finances to allow them to make decisions on what sort of bank account to give them and their lending options.

2.4 A balance sheet shows the businesses total assets, liabilities and capital at that moment in time capturing their current financial position. Current assets are classed as physical cash, cash in the bank, petty cash, and stock to sell. Listed underneath current assets are investments, which is then followed on by land, property, machinery, furniture and vehicles. Intangible assets are then listed and are not physical items and often include copyright names, trademarks, and patents.

Next the businesses liabilities are shown starting with current liabilities which are suppliers, salaries and wages, interest, tax and deposits. Long term liabilities are items such as mortgages, hire and lease purchases, and loans.

Following liabilities, you then have capital which is any money that has been invested by the owner or shareholders, and any retained earnings.

Sonia has invested £1,500 into Delicious. This would debit the asset cash with £1,500 and then credit the capital with £1,500.

Current Assets	**£**	**Current Liabilities**	**£**
Inventory		Creditors	
Debtors		Wages	
Bank	1500	HMRC	
Non-current Assets		**Long Term Liabilities**	
Buildings		Mortgage	
Vehicle		Lease Purchase	
Machinery		**Capital**	1500

Delicious have decided to borrow money to purchase the van. If they went for the lease purchase option, they would need to pay a deposit. If Delicious paid £1,000 deposit, the bank balance under asset would reduce from £1,500 to £500. The total cost of the van is £8500 therefore, this would be listed under vehicle as £8,500. Delicious paid £1,000 as a deposit, therefore, the Lease Purchase is £8,500 minus £1,000 totalling £7,500 to be listed under Long Term Liabilities.

Current Assets	**£**	**Current Liabilities**	**£**
Inventory		Creditors	
Debtors		Wages	
Bank	500	HMRC	
Non-current Assets		**Long Term Liabilities**	
Buildings		Mortgage	
Vehicle	8500	Lease Purchase	7500
Machinery		**Capital**	1500

Delicious will need to work out depreciation of the vehicle. This is the reduction of the value of the van over a period of time. This is worked out due to the wear and tear of the asset as at some point the van will no longer be fit for use. “Without depreciation accounting, the entire cost of a fixed

asset will be recognized in the year of purchase. This will give a misleading view of the profitability of the entity." (Accounting Simplified, 2016). Depreciation for vehicles is usually calculated by taking 25% off the purchase price for 5 years. After the 1st year under assets, the van will show as £6,375, in the 2nd year the van will show as £4,7821.25, 3rd year will show as £3,585.94, 4th year will show as £2,689.45 and in the 5th year the amount will be £2,017.09.

Current Assets	**£**	**Current Liabilities**	**£**
Inventory		Creditors	
Debtors		Wages	
Bank	500	HMRC	
Non-current Assets		**Long Term Liabilities**	
Buildings		Mortgage	
Accum Depreciation		Lease Purchase	7500
Vehicle	8,500		
Accum Depreciation	-2,125		
Machinery		**Capital**	1500
Accum Depreciation			
		Profit & Loss Account	-2,125
	£6,875.00		£6,875.00

In the Profit and Loss account, depreciation is shown as an overhead expense and affects the total profit or loss of your business. In the 1st year depreciation will show as £2,125, in the 2nd year £1,593.75, in the 3rd year £1,195.31, in the 4th year £869.48 and in the 5th year £672.36.

Delicious Profit & Loss Statement					
	2016	2017	2018	2019	2020
Sales					
Direct Cost of Sales					
Gross Margin	£0	£0	£0	£0	£0
Expenses					
Payroll					
Advertising					
Depreciation	-£2,125	-£1,594	-£1,195	-£869	-£672
Utilities					
Total Operating Expenses	-£2,125	-£1,594	-£1,195	-£869	-£672
Interest Expenses					
EBITDA					
Net Profit	-£2,125	-£1,594	-£1,195	-£869	-£672

Bibliography

Accounting Simplified, 2016. *Depreciation.* [Online]
Available at: http://accounting-simplified.com/financial/fixed-assets/depreciation-methods/
[Accessed 29 11 2016].

Barclays, 2016. *Business Loan Calculator.* [Online]
Available at: https://www.barclays.co.uk/Businesslending/Businessloancalculator/P1242649179882
[Accessed 24 11 2016].

Barclays, 2016. *Loans.* [Online]
Available at: http://www.barclays.co.uk/business-banking/borrow/loans
[Accessed 23 11 2016].

Barclays, 2016. *Overdrafts.* [Online]
Available at: http://www.barclays.co.uk/business-banking/borrow/overdrafts
[Accessed 24 11 2016].

Carter, W. B., Shaver, K. G., Carter, N. M. & Reynolds, P. D., 2004. *Handbook of Entrepreneurial Dynamics: The Process of Business Creation.* 1st ed. London: Sage Publications.

Clark, D., 2013. *10 Reasons Why Financial Planning Is Essential for Small Businesses.* [Online]
Available at: http://www.smallbusinessbonfire.com/small-business-financial-planning/#
[Accessed 25 11 2016].

GOV.UK, 2016. *Running a business partnership.* [Online]
Available at: https://www.gov.uk/set-up-business-partnership/partnership-tax-return
[Accessed 25 11 2016].

Hill, B., 2016. *Developing a Financial Plan For a Small Business.* [Online]
Available at: http://smallbusiness.chron.com/developing-financial-plan-small-business-4714.html
[Accessed 25 11 2016].

HSBC, 2014. *Small Business Loan Calculator.* [Online]
Available at: http://www.business.hsbc.co.uk/1/2/business-banking/business-loans-and-finance/small-business-loan/calculator
[Accessed 24 11 2016].

Lloyds, 2016. *Business Loan Calculator.* [Online]
Available at: https://secure.form.lloydsbank.com/business/bl_enquire_loan.asp?WT.ac=RBB_Loans_Calc
[Accessed 24 11 2016].

Lombard, 2016. *Hire Purchase Quote.* [Online]
Available at: https://carandvanfinance.lombard.co.uk/#/get-quote
[Accessed 24 11 2016].

Low Cost Vans, 2016. *Finance Options.* [Online]
Available at: http://www.lowcostvans.co.uk/Finance-Options.aspx
[Accessed 24 11 2016].

Nobel, C., 2011. *Why Companies Fail and How Their Founders Can Bounce Back,* Boston: Harvard Business School.

Pearson, 2016. *Identifying stakeholders and their relevance.* [Online]
Available at:
http://www.contentextra.com/publicrelations/files/topicguides/PR_TopicGuide_13_1.pdf
[Accessed 25 11 2016].

Royal Bank of Scotland, 2016. *Business Credit Card.* [Online]
Available at: http://www.business.rbs.co.uk/business/start-ups/cards-and-payments/business-credit-and-debit-cards/business-credit-card.html
[Accessed 24 11 2016].

Start Up Loans, 2016. *How Do I Apply?.* [Online]
Available at: https://www.startuploans.co.uk/how-do-i-apply/
[Accessed 24 11 2016].

Start Up Loans, 2016. *Loan Repayment Calculator.* [Online]
Available at: https://www.startuploans.co.uk/loan-repayment-calculator/
[Accessed 24 11 2016].

Start Up Loans, 2016. *Start or Grow Your Own Business.* [Online]
Available at: https://www.startuploans.co.uk/
[Accessed 24 11 2016].

Unison Drive, 2016. *Take Control of Your Car Finance.* [Online]
Available at: http://www.unisondrive.org.uk/car-finance
[Accessed 24 11 2016].