Lesson 2: External sources of finance

KNOWLEDGE ORGANISER

3.6 journey 1 2 3 4 5 6 7 Lesson 2 of 7

🎯 Learning goals

- ✓ Explain what external finance means
- ✓ Describe the main external sources
- ✓ Give advantages and drawbacks of each
- ✓ Recommend a suitable external source for a situation

🔑 Key words

External finance Money raised from outside the business.

Bank loan A sum borrowed and repaid with interest over time.

Overdraft Spending more than is in the bank account, up to a limit.

Trade credit Buying goods now and paying the supplier later.

Share issue Selling shares in a company to raise money.

📘 What you need to know

External finance is raised from outside the business.

1. Borrowing from a bank

External finance is money raised **from outside** the business. A bank loan is a sum borrowed and repaid in instalments **with interest** — good for larger, planned spending, but it raises costs and must be repaid. An overdraft lets a business **spend a bit more than is in its account**, up to a limit — handy for short-term gaps, but interest is high.

2. Other external sources

Trade credit means buying goods now and **paying the supplier later** (e.g. in 30 days) — it helps cash flow but isn't free money. A share issue sells **shares in a company** to raise large amounts (limited companies only), but owners give up some control. Other sources include **leasing** (renting an asset instead of buying), **government grants** (often no repayment, but conditions apply), **crowdfunding** (small amounts from many people online), and **family and friends**.

> *"Loans suit big, planned costs; overdrafts and trade credit suit short-term cash gaps."*

3. Choosing wisely

The right source depends on **how much** is needed, **how long** for, the **cost** (interest), and the **type of business** (only companies can issue shares). A sole trader like Pedal Power can't issue shares, so it relies on loans, overdrafts, trade credit, leasing or grants.

✅ Test yourself

Cover the answers below, answer Q7–Q15, then check.

Q7 What are external sources of finance?
Q8 What is a bank loan?
Q9 What is an overdraft?
Q10 What is trade credit?
Q11 What is a share issue?
Q12 What is a government grant?
Q13 What is crowdfunding?
Q14 What is leasing?
Q15 Give one drawback of a bank loan.

ANSWERS

A7 Money raised from outside the business.
A8 A sum borrowed from a bank, repaid with interest over time.
A9 An arrangement letting a business spend more than is in its account, up to a limit.
A10 Buying goods now and paying the supplier later (e.g. in 30 days).
A11 Selling shares in the company to raise finance (for a limited company).
A12 Money given by the government that usually does not need repaying.
A13 Raising small amounts of money from many people, often online.
A14 Renting an asset rather than buying it, paying regular amounts.
A15 Interest must be paid, increasing the total cost.