

Acquisition

When considering appropriate **sources of finance**, the enterprise must consider three main issues:

❖ **internal** or **external**?

Are funds available from within the organisation, or must the firm look outside for the resources to finance a project?

❖ **debt** or **equity**?

Should the firm take on some contractual obligation to repay a loan (with, almost certainly interest payments), or should new shares be issued, potentially diluting the control of the existing shareholders?

❖ **long, medium** or **short term**?

What time scale should any liability (taken out to finance the asset purchased) be?

1. Internal v External?

When financial resources are available internally, firms will tend to use these rather than look outside. Why? When borrowing, the firm will have to pay **interest** on its **debts**; when saving its **profits**, it will again receive interest. However, the cost of borrowing is considerably higher than the reward for saving. Therefore, using internal sources can have a much lower **opportunity cost**.

2. Debt v Equity

For larger scale finance needs, the business must choose between the costs and benefits of raising finance through selling more **shares** or from **borrowing**.

	Advantages	Disadvantages
Debt	As long as the business keeps to the terms of the contract, ie it meets the schedule for debt repayments, then the banks will leave management alone to run the business as they wish. There is no loss of control to outside influences.	The contract for the debt will set out a schedule for repayments that must be met whatever the current business conditions. This is not a problem when sales are high, but during an economic slowdown with weak revenues, it can represent a real threat to cashflows, perhaps forcing the firm into liquidation.
Equity	Debt repayments are legally binding, as set out in the contract. Dividends on shareholdings are not and so, during periods of poor cash inflows, management may be able to persuade shareholders that it is in the firm's best interests to retain cash within the business, to help cope with difficult conditions and allow long term survival.	If new shares are issued but are not purchased by existing shareholders, then the proportion held by any of these will fall and thus their relative share of voting power will shrink. New owners of shares may have different goals and thus corporate aims and objectives may be changed. There is a dilution of control for existing shareholders