

Beat the Teacher

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Bank finance

Banks are an important source of finance for many businesses, including those at the start-up or small business stage.

The two main types of business finance provided by banks are:

- Bank loans, and
- Bank overdrafts

A bank loan is a medium or long-term source of finance. The loan provides a fixed sum of money which the business has to use for a specific, agreed purpose. The rate of interest on a bank loan will always be fixed so that the business can plan cash flows with more certainty. The bank may also require the business to provide some security against the loan.

Bank loans are available to incorporated businesses due to the security of limited liability that a company provides.

By contrast, a bank overdraft should mainly be used as a source of short-term finance. The overdraft consists of a “facility” whereby the business can spend more than the cash it has in its bank account, up to an agreed limit. A bank overdraft has several advantages as a source of finance:

- The rate of interest is generally lower than a bank loan
- Interest is only paid on the amount overdrawn
- The bank overdraft doesn't have to be repaid if the bank requires it
- It is a flexible way of managing seasonal or temporary cash flow problems