

Cambridge AS & A Level · Accounting 9706 · Notes

Types of business entity

AS

Read online at pastopic.com/cambridge/accounting-9706/notes/types-of-business-entity

Last checked 30 September 2026

© 2026 Pastopic. Free for personal study. Please share the link, not the file.

What you need to know

By the end of this topic you should be able to:

1. **Describe the three types of business entity:** the **sole trader** (one owner), the **partnership** (two or more owners who share the business) and the **limited company**, either a private limited company (Ltd) or a **public limited company (plc)**.
2. **Give the advantages and disadvantages of each type**, and compare one type with another (for example, why a partnership might become a limited company).
3. **Describe the ways each type can raise money**, and say which types can use each one:
 - loans, **secured** (backed by an asset) and **unsecured**;
 - **bank overdrafts**;
 - **payment by instalments**;
 - **renting or leasing** an asset instead of buying it;
 - **trade credit** from suppliers;
 - for limited companies, issuing **ordinary shares**, making a **rights issue** and issuing **debentures** (and knowing that a **bonus issue** raises no money).
4. **Use all of this to make decisions:** advise an owner which type of business to set up, or which source of finance to use, and justify the advice.

Limited liability partnerships are **not** examined. How to record share issues and prepare company statements is part of "Preparation of financial statements".

Understand it

Why the type of business matters

Anyone starting a business has to decide who will own it, who will run it, who will pay if it fails, and where the money will come from. The **type of business entity** answers these questions. It decides:

- **liability:** whether the owners can lose their own house and savings if the business cannot pay its debts;
- **legal identity:** whether the business is a separate "person" in law or just the owners trading;
- **control:** who makes decisions, and whether ownership and management are the same people;

- **finance:** how much money the business can raise, and from where;
- **paperwork:** how many rules it must follow, and whether its financial statements must be made public.

Sole trader

A **sole trader** is one person who owns the business and takes all its profit. The owner may employ staff; "sole" refers to the ownership, not the number of workers.

- **Ownership and control are the same person.** The owner makes every decision quickly and alone.
- **No separate legal identity.** In law the owner and the business are one. Contracts and debts are the owner's.
- **Unlimited liability.** If the business cannot pay its debts, the owner's personal assets can be taken to pay them.
- **Easy and cheap to set up**, with few legal formalities. There is **no legal requirement to keep full accounting records** (many keep only minimal ones) and nothing has to be published, so the business stays private.
- **The owner takes drawings, not a salary.** Money or goods taken for personal use are drawings, which reduce the owner's capital. Drawings can be more than the profit for the year: the capital simply falls. There is no salary, no interest on capital and no current account (those belong to partnerships), and no retained earnings account (that belongs to companies).
- The owner's **personal spending is not a business expense**, so it never appears in the statement of profit or loss.
- **Finance is limited** to the owner's savings, profits kept in the business and what a bank or supplier will lend to one person. A sole trader **can** borrow from a bank, but usually only smaller amounts.
- **All the work and risk fall on one person:** no one to share ideas or workload with, and the business may stop if the owner is ill or dies.

Partnership

A **partnership** is two or more people who own and run a business together, aiming to make a profit. Partners usually write a **partnership agreement** that sets out how profits are shared, and any salaries, interest on capital and interest on drawings.

Compared with a sole trader, a partnership has:

- **more capital**, because each partner puts money in, and banks may lend more to several owners;
- **more skills and ideas:** partners can bring different expertise, and share the workload and responsibility for running the business;
- **cover** when one partner is away.

But also:

- **profits are shared** between the partners;
- **disagreements** can arise, and decisions are slower because partners must agree;

- **each partner is bound by the others' decisions**, and each can be **liable for the debts and actions of the other partners**;
- **unlimited liability** still applies, so personal assets are still at risk;
- **no separate legal identity**, just as for a sole trader;
- the partnership may have to end or be restructured when a partner leaves or dies.

A partnership, like a sole trader, **does not have to publish** its financial statements.

Limited company

A **limited company** is owned by **shareholders**, who buy shares, and run by **directors**, whom the shareholders appoint. In a small company the shareholders and directors are often the same people.

- **Separate legal identity.** The company is a legal "person": it owns its assets, owes its debts, makes contracts and can sue or be sued in its own name.
- **Limited liability.** If the company fails, a shareholder can lose only the money paid for the shares. Their personal assets are protected. This is the main benefit to the owners.
- **Continuity.** The company carries on when shareholders sell their shares or die.
- **More finance.** It can issue shares and **debentures**, and lenders see it as more stable, so borrowing is easier.
- **Status.** Customers and suppliers often see a company as more credible than a sole trader or partnership.
- **Directors are paid salaries** as employees, and shareholders receive **dividends** out of profit, when the directors decide to pay them.

The costs:

- **legal formalities and expense** to set up and run (registration, company rules, meetings);
- **more regulation:** financial statements must be prepared in a set format and **published**, so competitors can see them, and larger companies need an audit;
- **ownership and control can separate:** the directors run the company, and shareholders who sell shares to outsiders can lose control;
- profits are shared as dividends among all shareholders.

Private and public companies. A **private limited company (Ltd)** cannot offer its shares to the public; its shares are usually held by family, friends or the founders, so one person can own all of them. A **public limited company (plc)** can sell shares to the general public on a stock exchange. It can raise far more money, but anyone can buy its shares, so the original owners can lose control, and it faces the strictest rules.

The three types side by side

Feature	Sole trader	Partnership	Limited company
Owners	One	Two or more partners	Shareholders

Feature	Sole trader	Partnership	Limited company
Separate legal identity	No	No	Yes
Owners' liability	Unlimited	Unlimited	Limited to their shares
Must publish financial statements	No	No	Yes
Who makes decisions	The owner	The partners together	The directors
How owners are rewarded	All the profit (drawings)	Share of profit, as agreed	Dividends (directors get salaries)
Finance available	Owner's capital, loans, overdraft, trade credit, leasing	As sole trader, plus several partners' capital	All of these, plus shares and debentures
Continuity	Ends with the owner	May end when a partner leaves	Continues

Sources of finance

Finance is sorted in two ways.

- **By time.** **Short-term** finance is repaid within a year and pays for day-to-day needs such as inventory and wages. **Long-term** finance lasts more than a year and pays for non-current assets and expansion. Match the two: don't buy a building with an overdraft.
- **By origin.** **Internal** finance comes from inside the business (profits kept in the business, retained earnings in a company). **External** finance comes from outsiders (banks, suppliers, leasing firms, new shareholders, debenture holders).

The syllabus names these sources:

- **Bank loan.** A fixed sum, borrowed for a fixed period (usually more than a year), repaid in regular amounts with interest. A **secured** loan is backed by an asset such as a building: if the business does not repay, the lender can sell that asset. Because the lender's risk is lower, a secured loan usually has a lower interest rate and can be larger. An **unsecured** loan has no asset behind it, so it is usually smaller and dearer. Interest must be paid whether or not the business makes a profit.
- **Bank overdraft.** Permission to take the bank account below zero, up to an agreed **limit**. The amount used goes up and down each day, and interest is charged only on the amount actually overdrawn. It is **short-term** and flexible, good for gaps in cash flow, but its interest rate is usually high and the bank can ask for repayment at short notice.
- **Payment by instalments.** Buy an asset now and pay for it in parts over a period. The business uses the asset straight away without one large payment, so its bank balance stays higher (or its overdraft stays lower) than if it paid in full. The total paid is usually more than the cash price, because interest is built in, and the amount still owed is a liability: a **current** liability if it is due within 12 months.

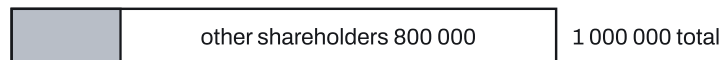
- **Renting or leasing.** Pay a regular charge to use an asset (a vehicle, a machine, premises) that the business does not own. There is no large outlay, repairs are often included, and the asset can be replaced with a newer one when the lease ends. But the payments continue for as long as the asset is used, the total can be more than buying, and at the end the business owns nothing.
- **Trade credit.** A supplier lets the business take goods now and pay later, often 30 or 60 days. It is **short-term** and usually free, but paying late damages the relationship, and paying later may mean losing a cash discount.

A sole trader, a partnership and a company can all use every one of these.

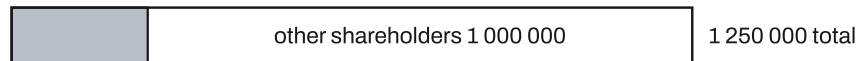
Extra sources for limited companies

Only companies can issue shares and debentures.

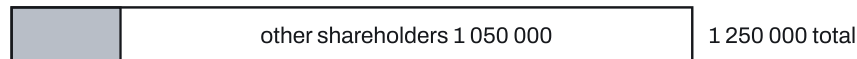
- **Ordinary shares.** Buyers become part-owners, with a vote at general meetings and a right to dividends when the directors declare them. The money is **permanent**: the company never has to repay it, and dividends are not compulsory. Each share has a **nominal (par) value**, such as 1 or 0.25. Shares are often issued **at a premium**, above nominal value: the nominal value goes to share capital and the extra to **share premium**. Selling shares to new investors spreads ownership, so existing shareholders' share of control falls.
- **Rights issue.** New shares are offered to **existing** shareholders in proportion to what they already hold, for example "1 for 4": one new share for every four held. The price is usually below the market price, which makes it attractive. If every shareholder takes up their rights (the issue is **fully subscribed**), each keeps exactly the same proportion of the company, so **control does not change**. It raises cash, and no interest has to be paid.
- **Bonus issue.** Free shares given to existing shareholders out of reserves. **No cash comes in**, so a bonus issue is **not** a source of finance. It changes reserves into share capital, and each shareholder's proportion stays the same.
- **Debentures.** Long-term loans to the company, usually for a fixed number of years, with a fixed rate of interest, written like "8% debentures 2032" (8% interest a year, repaid in 2032). Debenture holders are **lenders, not owners**: they have no vote, so issuing debentures does not change control. Interest must be paid every year **whether or not there is a profit**, and it is paid before any dividend. Debentures are usually secured on the company's assets, and they must be repaid (redeemed) on the date set.

Before

Her shares (shaded): $200\,000 \div 1\,000\,000 = 20\%$

After a 1-for-4 rights issue (she takes up her rights)

Her shares (shaded): $250\,000 \div 1\,250\,000 = 20\%$

After a new issue of 250 000 shares to outsiders

Her shares (shaded): $200\,000 \div 1\,250\,000 = 16\%$

The diagram shows why a rights issue protects existing shareholders' control and a general share issue does not. K plc has 1 000 000 ordinary shares and a shareholder owns 200 000 of them (20%). A 1-for-4 rights issue creates $1\,000\,000 \div 4 = 250\,000$ new shares. She is offered $200\,000 \div 4 = 50\,000$ of them; if she buys them she has 250 000 of 1 250 000, still 20%. If the same 250 000 shares are sold to outsiders instead, she keeps 200 000 of 1 250 000, only 16%. Debentures leave her at 20% too, but they add interest that must be paid before any dividend.

Choosing a source of finance

Ask these questions:

- 1. What is the money for, and for how long?** Short-term needs (inventory, a seasonal gap): overdraft or trade credit. Assets that last years: a loan, instalments, leasing, shares or debentures.
- 2. Which sources can this business use?** Only companies can issue shares or debentures, and only a plc can sell shares to the public.
- 3. What does it cost?** Interest on loans, overdrafts and debentures; the extra built into instalments and leases; dividends expected by shareholders. When interest rates are high, borrowing is expensive, so shares look better.
- 4. Must it be repaid?** Loans, debentures and overdrafts must be; share capital never is.
- 5. Who controls the business afterwards?** New shareholders get votes; lenders don't. A rights issue keeps control where it is.
- 6. Is there an asset to offer as security?** Without one, a large loan may be refused or cost more.

Key facts and formulas

There is no formula list in the 9706 exam, so learn all of these.

Formula

Status

Interest for a period = amount $\times$ annual rate $\times \frac{\text{months}}{12}$

Learn
it

Formula	Status
Debenture interest per year = nominal value of debentures $\times$ rate	Learn it
New shares in an "a for b" rights or bonus issue = shares held $\times \frac{a}{b}$	Learn it
Cash from a share issue = number of shares $\times$ issue price	Learn it
Share capital increase = number of shares $\times$ nominal value; share premium = number of shares $\times$ (issue price – nominal value)	Learn it
Shareholder's share of the company = $\frac{\text{shares held}}{\text{total shares in issue}} \times 100\%$	Learn it
Total cost of leasing = payment $\times$ number of payments	Learn it
Net cost of buying with a loan = price + interest – value of the asset at the end	Learn it

Key facts to learn:

- **Separate legal identity and limited liability:** limited companies only.
- **Must publish financial statements:** limited companies only.
- **Salary for an owner, interest on capital, current accounts:** partnerships (by agreement), not sole traders. Company directors get salaries.
- **Shares and debentures:** limited companies only; **selling shares to the public:** plc only.
- **Short-term:** overdraft, trade credit. **Long-term:** bank loan, debentures, shares, rights issue; leasing and instalments usually cover the life of the asset.
- **Raises no cash:** bonus issue. **Keeps control unchanged:** a fully subscribed rights issue, or debentures.

How to do it

We have 26 tagged questions for this topic from 2021 to 2025. Two of them appear on two paper variants, so there are 24 different questions, and each is one type:

Question type	Questions
Features, advantages and disadvantages of each type (multiple choice)	10
Sources of finance (multiple choice)	7
Choosing or changing the type of business (multiple choice)	4
Explain or advise in writing: one type or source compared with another	3

1. Features, advantages and disadvantages of each type (10 questions)

These are Paper 1 questions with numbered statements ("Which statements are true?") or a two-column table ("Which row shows an advantage and a disadvantage?").

1. **Note which entity the question is about, and what it is being compared with.** "Disadvantages of a partnership **compared to** a sole trader" means things that are worse because there are partners (profits shared, disputes, liable for partners' actions), not unlimited liability, which both have.
2. **Test each statement on its own** against the side-by-side table: true or false for this entity?
3. **Check it is the right kind of point.** An "advantage" must be good for the owner; "unlimited liability" is true of a sole trader but it is a **disadvantage**.
4. Choose the option that contains exactly the true statements.

Variations you will meet:

- **"Which statement relates to a sole trader?"** Watch for company words (separate legal entity, retained earnings, shareholders) and partnership words (interest on capital, salary, current account), which are wrong for a sole trader. "No separation between ownership and control" and "no legal requirement to keep full accounting records" are right.
- **"Which is not correct?"** A sole trader **can** get a bank loan and drawings **are** transferred to the capital account, but personal expenses are **never** in the statement of profit or loss.
- **Row questions:** both halves of the row must be right. "Limited liability" as a partnership advantage is wrong, so any row with it is out; "access to more expertise" with "unlimited liability" is right.
- **"Always" and "never" statements**, such as "sole traders never employ staff" or "always buy and sell goods", are usually false: a sole trader may run a service business and employ people.

2. Sources of finance (7 questions)

1. **Place the source** on the two scales: short-term or long-term, internal or external.
2. **Check who can use it:** debentures and shares are for companies only; the others are for everyone.
3. **Think about the effect** on cash, liabilities and control.

Variations you will meet:

- **Overdraft features.** It is **short-term** and of a **variable amount up to a limit**, not long-term and not a fixed amount (that describes a loan).
- **Long-term sources of additional funds:** bank loans, leasing premises, rights issues and debentures. Rule out any list with **trade credit** (short-term) or a **bonus issue** (no cash).
- **External short-term sources:** overdraft and trade credit. Retained earnings are internal; share capital is long-term.
- **Which source keeps control and suits high interest rates?** Rule out a new share issue to outsiders (control changes), debentures (interest is expensive when rates are high) and a bonus issue (no cash). A fully subscribed **rights issue** is left.

- **Protecting existing shareholders' interest** when raising money for a big project: a fully subscribed rights issue. Their share of ownership is unchanged, they buy at a lower price, and there is no interest charge or lender's claim ranking ahead of them.
- **Effect of paying by instalments.** Compared with paying in full, less cash leaves at once, so the bank balance is higher or the **overdraft lower**. The instalments still owed within the year are a current liability, not a non-current one.
- **Available to a plc but not a partnership:** debentures (or shares). Overdrafts, leasing and trade credit are available to both.

3. Choosing or changing the type of business (4 questions)

1. **List what the owner wants:** sole ownership, a salary, protection of personal assets, more capital, shared skills, privacy.
2. **Match each want to a type:** limited liability or a salary as a director point to a company; full ownership rules out a partnership and makes a plc unlikely (anyone can buy its shares), so it points to a sole trader or a **private** limited company; more capital or someone with different skills points to a partnership.
3. Pick the type that meets **all** of them.

Variations you will meet:

- **Why a sole trader takes on a partner:** extra capital, and a partner with different expertise. Not limited liability (partners don't have it), and not certainty of no disagreements, fewer legal requirements or privacy (a sole trader already has those).
- **Partners converting to a company, benefit to them as shareholders:** their **personal assets are protected** (limited liability). Disputes are not settled by a general meeting, the share value is not certain to rise, and their personal finances become **separate**, not joined.
- **Owner wants a salary, full ownership and no risk to personal assets:** a private limited company, where the owner can hold every share and be paid as a director.

4. Explain or advise in writing (3 questions)

Paper 2 asks this in 4-mark parts, such as "Explain two benefits of trading as a limited company rather than as a partnership" or "Explain two reasons why investors may prefer debentures to ordinary shares". Each point earns **1 mark for identifying it and 1 mark for developing it** (saying what it means for the people in the question).

1. **Identify** the point in a few words: "shareholders have limited liability".
2. **Develop** it with "which means..." or "so...": "so their personal assets are not at risk if the company cannot pay its debts".
3. **Compare** when the question says "rather than": say why it is better than the other option, not just a fact about one of them.
4. **Use the business in the question** where you can (its partners, its debts, its plans).

Points that earn marks:

- **Limited company rather than partnership:** limited liability (personal assets safe); separate legal identity (sues and is sued in its own name, carries on if owners change); more finance (can issue shares, easier to borrow); status (seen as more stable, may attract customers and suppliers).
- **Partnership rather than limited company:** no need to publish financial statements (privacy from competitors); fewer legal formalities and lower costs; partners keep full control and share all profit.
- **Investor's view, debentures rather than shares:** fixed interest every year, paid whether or not there is a profit, while dividends are at the directors' choice; less risk, because debentures are usually secured on assets and are repaid before shareholders get anything.
- **Company's view, rights issue rather than debentures:** permanent finance, never repaid; no interest to pay, and dividends can be skipped in a bad year; no assets tied up as security; control unchanged if fully subscribed.

Advise questions (for example, whether to take a partner or a bank loan to expand) need a clear decision, backed by points on **both** sides: what is good about your choice and what is weak about the other option (not the same point twice).

Worked examples

Example 1

Priya runs a bakery as a sole trader. She plans to take her cousin into the business as a partner.

Which statements about the change are correct?

1. More capital can be put into the business.
2. Priya will have limited liability.
3. Responsibility for decisions will be shared.
4. The business will have to publish its financial statements.

A 1 and 3 only B 1, 2 and 3 C 2 and 4 D 3 and 4 **[1]**

Test each statement:

1. True: the cousin can put in capital.
2. False: partners have unlimited liability, just like a sole trader.
3. True: partners share running the business.
4. False: only limited companies must publish.

The answer is **A** (1).

Example 2

Jo and Ken run a successful partnership. They are considering converting it into a private limited company.

Explain **two** disadvantages to Jo and Ken of converting the partnership into a limited company. [4]

Model answer

1. The company must prepare its financial statements in a set format and publish them (1), so competitors will be able to see its revenue and profit, which Jo and Ken can keep private as partners (1).
2. There are legal formalities and costs in forming and running a company (1), such as registration fees and possibly an audit, which will reduce the profit left for Jo and Ken (1).

Other valid points: profits must be shared as dividends if shares are sold to others, and Jo and Ken could lose control of decisions if outsiders buy shares.

Example 3

Rafael is a sole trader. He needs a delivery van, costing \$24 000, for the next three years. He has two options.

- **Option 1:** a three-year bank loan of \$24 000 at 8% a year, secured on the van. Interest is paid at the end of each year and the loan is repaid in full after three years. The van could then be sold for \$3000.
- **Option 2:** lease a van for \$700 a month for three years. The leasing company pays for all repairs, and the van is returned at the end.

(a) Calculate the net cost to Rafael of each option over the three years. [4]

(b) Advise Rafael which option he should choose. Justify your answer. [4]

(a) Option 1: interest per year = $\$24\,000 \times 8\% = \1920 (1); for three years = $\$1920 \times 3 = \5760 (1).

$$\text{Net cost} = 24\,000 + 5760 - 3000 = \$26\,760 \quad (1)$$

Option 2: $\$700 \times 36 = \$25\,200$ (1).

(b) Rafael should choose **Option 2**, leasing (1). It is $\$26\,760 - \$25\,200 = \$1560$ cheaper over the three years (1). He also has no repair bills to pay (1), and his van is not used as security for a loan, so he could replace it with a newer one when the lease ends (1). Against this, with Option 1 he would own the van and could keep using it after three years (1), and the loan interest is a fixed cost he can plan for. Any four of these points earn the marks (max 4).

Either choice earns the decision mark if it is justified; the marks are for reasons on both sides.

Example 4

K plc has 1 000 000 ordinary shares of \$1 each in issue. It needs \$600 000 to build a new factory. The directors are considering:

- **Option A:** a rights issue of 1 new share for every 4 held, at \$2.40 per share, which will be fully subscribed;
- **Option B:** issuing \$600 000 of 7% debentures, repayable in 2035.

(a) Calculate the number of shares to be issued under Option A and the amount that will be credited to the share premium account. [3]

(b) Calculate the annual debenture interest under Option B. [1]

(c) Explain **two** reasons why the directors might prefer Option A. [4]

(a) New shares = $1\,000\,000 \times \frac{1}{4} = 250\,000$ (1).

Cash received = $250\,000 \times \$2.40 = \$600\,000$, which is the amount needed.

Share premium = $250\,000 \times (\$2.40 - \$1.00) = \$350\,000$ (1) (1), and share capital rises by $250\,000 \times \$1 = \$250\,000$.

(b) $\$600\,000 \times 7\% = \$42\,000$ a year (1).

(c)

1. A rights issue is permanent finance (1), so the company will never have to find \$600 000 to repay it, as it would to redeem the debentures in 2035 (1).
2. There is no interest to pay (1): the \$42 000 debenture interest would have to be paid every year even if the new factory made a loss, while dividends are paid only when the directors choose (1).

Another valid reason: because the issue is fully subscribed, each shareholder keeps the same share of the company, so control does not change (the diagram in "Understand it" uses these numbers).

Common mistakes

- **Mixing up the entities.** It is easy to give a sole trader interest on capital or a salary (those belong to partnerships), or to give partners limited liability (only company shareholders have it). Learn the side-by-side table and check each statement against it.
- **Answering the wrong comparison.** When asked for an advantage of a partnership **rather than a limited company**, some candidates wrote about a partnership compared with a sole trader. Read who is compared with whom before writing.
- **Treating a bonus issue as a source of cash.** A bonus issue raises nothing; it only turns reserves into shares. Candidates have claimed it helps pay creditors or lenders.
- **Listing facts instead of comparing.** In "why a rights issue rather than debentures", stating a feature of one option earns little. Say how it differs from the other: permanent versus repayable, dividends at the directors' choice versus interest that must be paid.
- **Vague points about control.** "Shareholders have a say" is too loose. Say who gains votes (new shareholders) and why that matters (existing owners' share of control falls).
- **Identifying without developing.** In "explain" parts, many candidates name a point and stop, so they lose the second mark each time.
- **Using \$1 as the share value when it isn't.** When shares are \$0.25 or \$0.50, count the shares from the nominal value given, and use the full issue price (nominal plus premium) for the cash raised.

- **Advice without both sides.** Answers that give only the points for one option, or repeat the same reason as a point against the other option, reach only half the marks.

How to get the marks

- **Multiple choice:** check every numbered statement separately. The key is the option with all of the true statements and none of the false ones.
- **"State"** needs a short phrase for each mark: "trade credit", "write off share issue expenses".
- **"Explain"** gives 2 marks a point: identify it (1), then develop it with its effect on the business or its owners (1). Two points for 4 marks; don't write a third instead of developing the first two.
- **"Rather than"** questions need comparative points. Name both options in the sentence if that helps.
- **"Calculate"** answers need the working and the dollar sign. A mark scheme marked **OF** (own figure) still gives the mark for a correct method on your earlier wrong figure, so always show it.
- **"Advise" and "Justify"**: give a clear decision (1), then reasons for it and against the other choice, using figures from the question where there are any. A decision with no reasons earns only the first mark.
- **Use the scenario.** Answers about "the business" in general score less than answers about the partners, the company or the plan in the question.

Quick check

1. Which is a feature of a private limited company but not of a partnership? A unlimited liability for its owners
B a separate legal identity C profits shared among the owners D the ability to borrow from a bank
2. Sort these into short-term and long-term sources of finance: bank overdraft, 6% debentures 2031, trade credit, rights issue of shares, five-year secured bank loan.
3. A business needs extra money for six months. It could use an overdraft at 15% a year, charged only on the amount used, which will average \$4000 over the six months. Or it could take a six-month loan of \$10 000 at 9% a year, with interest charged on the whole amount. Calculate the interest on each and state which is cheaper.
4. A company has 150 000 ordinary shares in issue and makes a bonus issue of 1 for 5. A shareholder owned 30 000 shares before the issue. Calculate how many shares she owns afterwards, her percentage of the company before and after, and the cash the company receives.
5. Explain **one** advantage to a sole trader of using trade credit. [2]

Answers

1. **B.** Only a company is a separate legal person. Partners have unlimited liability (A), companies also share profits among owners (C), and both can borrow (D).
2. Short-term: bank overdraft, trade credit. Long-term: debentures, rights issue, five-year bank loan.
3. Overdraft: $\$4000 \times 15\% \times 6/12 = \300 . Loan: $\$10\,000 \times 9\% \times 6/12 = \450 . The overdraft is cheaper by \$150, even though its rate is higher, because interest is charged only on what is used.
4. Bonus shares = $30\,000 \times \frac{1}{5} = 6000$, so she owns 36 000. Total shares = $150\,000 + 30\,000 = 180\,000$.
Before: $\frac{30\,000}{150\,000} = 20\%$; after: $\frac{36\,000}{180\,000} = 20\%$. The company receives \$0: a bonus issue raises no cash.
5. The trader can sell the goods before paying the supplier (1), so no bank overdraft or loan is needed to buy inventory and no interest is paid (1).

Past questions to try

- 9706/11/M/J/24 Q1: choosing a type of business for an owner's needs.
- 9706/12/F/M/24 Q2: which finance only a company can use.
- 9706/11/O/N/23 Q1: external short-term sources of finance.
- 9706/21/M/J/24 Q3: part (b), why investors may prefer debentures to shares.