

Cambridge AS & A Level · Business 9609 · Notes

Sources of finance

AS

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What you need to know

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

1. **Explain how a business's legal form affects the finance it can get:** a sole trader, a partnership, a private limited company and a public limited company have different sources open to them.
2. **Describe the internal sources of finance:** the owners' own investment, retained earnings, selling assets the business no longer needs, sale and leaseback of non-current assets, and squeezing money out of working capital.
3. **Describe the external sources of finance:** share capital, debentures, new partners, venture capital, bank overdrafts, leasing, hire purchase, bank loans, mortgages, debt factoring, trade credit, micro-finance, crowdfunding and government grants.
4. **Explain the factors that influence which source a business chooses:** cost, flexibility, the wish to keep control, what the money will be used for, and how much the business already owes.
5. **Judge which source (or mix of sources) is most appropriate** for a particular business in a particular situation.

This builds on the previous topic, where you met short-term and long-term needs for finance. Gearing and the ratios that measure it belong to the accounts topics later; here you only need the idea that a business already deep in debt finds borrowing harder and riskier.

Understand it

Internal and external, short and long

A **source of finance** is where the money comes from. Two questions sort every source:

- **Internal or external?** **Internal** finance comes from inside the business or its owners' own resources: nobody new is involved. **External** finance comes from outside: a bank, a supplier, an investor, the government, the public.

- **Short term or long term?** **Short-term** finance is repaid or used up within a year and suits day-to-day needs (inventory, wages, a seasonal gap). **Long-term** finance lasts several years and suits non-current assets and growth (premises, machinery, a new branch). **Medium-term** (roughly one to five years) covers loans and agreements for equipment and vehicles.

The golden rule is to **match** the source to the need: long-term needs get long-term finance, short-term needs get short-term finance.

	Short term under 1 year	Medium term 1 to 5 years	Long term over 5 years
Internal	working capital: cut inventory, collect sooner		owners' investment retained earnings sale of unwanted assets sale and leaseback
External	bank overdraft trade credit debt factoring	bank loan leasing hire purchase micro-finance	mortgage share capital debentures venture capital new partners crowdfunding government grant

Some sources sit on the edges of the grid: a bank loan can run for ten years or more, and crowdfunding and grants are raised once rather than "repaid over" a period. The grid shows where each one is most often used.

How legal form decides what is available

The **form of ownership** (from the business structure topic) opens some doors and shuts others.

- **Sole trader:** can use the owner's savings, retained profit, bank overdrafts and loans, leasing, hire purchase, trade credit, micro-finance, crowdfunding and grants. It **cannot sell shares**, and banks may lend only small amounts because the business is small, has few assets to offer as security and often has a short trading record. The owner has **unlimited liability**, so a loan may be secured on their own house.
- **Partnership:** as a sole trader, plus **bringing in new partners**, who pay in capital (and often skills) in return for a share of the profit and a say in decisions.
- **Private limited company (Ltd):** can sell **shares**, but only privately, to people the existing shareholders agree to (family, friends, employees, a **venture capitalist**). **Limited liability** makes investors more willing to put money in.
- **Public limited company (plc):** can sell shares **to the public** on a stock exchange, raising very large sums, and can issue **debentures**. The costs of a share issue are high, the business must publish its accounts, and the original owners lose control of who owns it, so a takeover becomes possible.
- **Social enterprises, co-operatives and charities** may find banks cautious (profits are not the main aim, and a co-operative's many owners may be slow to agree), but they are well placed for **government grants**, **crowdfunding** from supporters and **micro-finance**.

Moving to a legal form with more options is itself a way to raise finance: a sole trader becomes a partnership to bring in a partner's capital; a private company **goes public** so it can sell shares to anyone.

Internal sources

- **Owners' investment:** the owners put in more of their own savings. No interest, no loss of control, but the amount is limited to what the owners have, and they risk their personal wealth.
- **Retained earnings** (retained profit): profit kept in the business instead of being paid out to the owners. No interest, no repayments, no new owners and quick to use. But a new or loss-making business has none, it may not be enough for a big project, and shareholders who get lower dividends may be unhappy. Using it also means the money is no longer there as a safety cushion.
- **Sale of unwanted assets:** selling machinery, vehicles, land or old inventory the business no longer needs. Turns idle assets into cash, but only works if there is something spare to sell, and a quick sale may fetch a low price.
- **Sale and leaseback:** the business **sells** a non-current asset it still needs (often a building) to a finance company or investor, then **leases it back** and carries on using it, paying a regular rent. It releases a large lump of cash that was locked in the asset **while the business keeps using the asset**. The lessor may handle maintenance. The costs: rent must be paid for years, the business no longer owns the asset (or benefits if its value rises), and the lease may not be renewed at the end.
- **Working capital:** freeing cash that is tied up in day-to-day running, by holding less inventory, collecting money from customers sooner or (carefully) taking longer to pay suppliers. Costs nothing, but there is a limit: cut too far and the business cannot meet orders or pay its bills.

External sources

Source	How it works	Term	Main strengths	Main drawbacks
Bank overdraft	The bank agrees that the current account can go below zero, down to a set limit	Short	Arranged in advance, used only when needed, interest paid only on the amount overdrawn and only while overdrawn	High interest; the bank can demand repayment at any time; limits are usually small; not for long-term needs
Trade credit	A supplier delivers now and allows, say, 30 or 60 days to pay	Short	No interest if paid on time; cash stays in the business longer	No new cash, only time; early-payment discounts lost; late payment harms the supplier relationship; new businesses may be refused it

Source	How it works	Term	Main strengths	Main drawbacks
Debt factoring	The business sells its unpaid customer invoices to a factoring company, which pays most of their value at once and then collects the debts	Short	Immediate cash; saves the time spent chasing late payers	The factor keeps a fee, so less than the full amount is received; customers may dislike dealing with a factor
Bank loan	A fixed sum borrowed for a set period, repaid in instalments with interest	Medium or long	Large sums; repayments known in advance, so easy to plan; no loss of ownership	Interest; repayments due even in a bad month; security (collateral) often needed; hard to get for a new business
Mortgage	A long-term loan to buy land or buildings, secured on the property itself	Long	Spreads the cost of premises over 20 years or more; lower interest because it is secured	The property can be taken if repayments are missed; commits the business for decades
Leasing	The business rents an asset (machinery, vehicles, IT) for a fixed period and pays a regular fee; the leasing company still owns it	Medium	No large upfront payment; maintenance often included; easy to swap for newer models at the end	Often costs more than buying over the asset's life; the business never owns it
Hire purchase (HP)	The business pays a deposit and then fixed instalments, and owns the asset after the last one	Medium	No large upfront payment; fixed instalments are easy to budget; the asset is owned in the end	Total cost is more than the cash price (interest is built in); the asset can be taken back if payments stop
Share capital	A company sells part-ownership (shares) to investors, who get a vote and dividends	Long (permanent)	Large sums; never repaid; no interest; dividends can be cut in a bad year	Ownership and control are diluted; profits are shared; a public issue is slow and costly
Debentures	A company borrows by selling long-term bonds to investors, who get fixed interest and are repaid on a set date	Long	Large sums; debenture holders have no vote, so control is kept	Interest must be paid whatever the profit; adds to debt

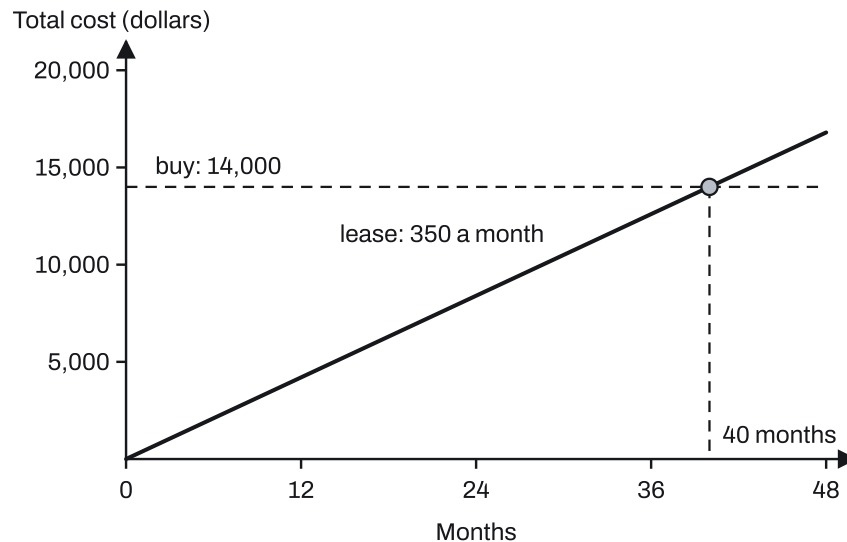
Source	How it works	Term	Main strengths	Main drawbacks
New partners	A partnership admits a partner who pays in capital	Long	New capital plus new skills and ideas	Profit and decisions shared; disagreements; still unlimited liability for most partners
Venture capital	Specialist investors put money (often a mix of shares and loans) into a risky, fast-growing small business in return for part-ownership	Long	Large sums where banks will not lend; investors bring expertise and contacts	A big share of ownership and a say in decisions given away; investors expect high returns and an exit within a few years
Micro-finance	Small loans to people on low incomes, often without a bank account or collateral, to start or run a small business	Short or medium	Finance for those banks ignore; often comes with training	Small amounts; it is a loan and must be repaid with interest
Crowdfunding	Many people each give a small amount online, as a donation, in return for a reward (often the product), for shares, or as a loan	Raised once	Reaches many backers; tests demand before production; publicity	Only received if the target is met; platform fees; the idea is public, so rivals can copy it
Government grant	Money from the government, usually for a project it wants to encourage (jobs in a poor region, research, green technology)	Raised once	Normally not repaid and no interest	Hard to get; strict conditions on how it is spent; paperwork and delays

Three pairs are easy to confuse:

- **Overdraft or loan?** An overdraft is a flexible limit you dip into for short gaps; a loan is a fixed sum for a set period, repaid in instalments. Using an overdraft to buy a building is a classic mistake.
- **Leasing or hire purchase?** Under leasing you **never own** the asset and pay a rental fee, not interest; under hire purchase you **own it** after the final instalment, and the instalments include interest.
- **Shares or debentures (or loans)?** Shareholders are **owners**: they get dividends only if the directors choose to pay them, and they vote. Debenture holders and banks are **lenders**: they get interest whatever happens, but no vote.

Leasing against buying: when does it pay?

A café can buy a coffee roaster for 14,000 dollars or lease it for 350 dollars a month. Leasing costs nothing upfront, but the payments add up: after $14000 \div 350 = 40$ months, the café will have paid as much in lease fees as the roaster cost to buy. If it expects to use the roaster for longer than 40 months, buying (perhaps on hire purchase) is cheaper; if the technology will be out of date in three years, or the café has no spare cash now, leasing makes sense.



The factors that influence the choice

The syllabus names five; examiners also reward a few more.

1. **Cost.** Interest on loans, overdrafts, debentures and HP; dividends and lost profit share for shares and venture capital; fees for factoring, crowdfunding and share issues. Internal sources are usually the cheapest. Higher interest rates make all borrowing more expensive.
2. **Flexibility.** Can the amount and timing change? An overdraft can be used one week and cleared the next; a ten-year loan has fixed repayments whatever happens.
3. **Need to keep control.** Selling shares, taking venture capital or admitting partners hands over part-ownership and votes. Owners who want to keep running the business their way prefer loans, retained earnings or leasing.
4. **The use the money is put to.** Match the term: premises → mortgage, retained earnings or shares; machinery and vehicles → loan, leasing or HP; inventory and wages → overdraft, trade credit or factoring. The amount matters too: a crowdfunding campaign will not fund a factory, and a share issue is too costly for a small sum.
5. **Level of existing debt.** A business that already owes a lot pays higher interest, may be refused further loans, and risks being unable to meet repayments if sales fall. It should look to share capital or internal sources instead.

Also credited: the **legal form** and **size** of the business; its **trading record and reputation** (a start-up with no accounts finds banks reluctant, so relies on the owners' savings, crowdfunding or micro-finance); the **security** it can offer; its **cash flow**, which decides whether it can afford regular repayments; and the **risk** of the project.

Selecting the source

To choose a source in a case, ask in turn:

1. **How much, and for what?** A large, long-lived asset or a small short-term gap?
2. **Who can provide it to this business?** Rule out what its legal form, size or record makes impossible (shares for a sole trader; a large bank loan for a brand-new firm with no assets).
3. **Can it afford the cost and repayments?** Look at its cash flow, its profit and what it already owes.
4. **What do the owners care about?** Keeping control, avoiding risk, speed.
5. **Is a mix better?** Many real projects combine sources: retained earnings for part of a new shop, a mortgage for the building, leasing for the tills.

The best answer is the source that fits **this** business's situation; the same source can be right for one business and wrong for another.

Key facts and formulas

There is no formula list for this subject in the exam. "Learn it" means you must remember it.

Fact or formula	Status
Internal finance comes from within the business or its owners (owners' investment, retained earnings, sale of unwanted assets, sale and leaseback, working capital); external finance comes from outside it	Learn it
Match the term: long-term needs (premises, machinery) need long-term finance; short-term needs (inventory, wages) need short-term finance	Learn it
Retained earnings: profit kept in the business rather than paid to the owners	Learn it
Sale and leaseback: selling a non-current asset and renting it back, so the business gets cash but keeps using the asset	Learn it
Overdraft: an agreed limit up to which a business may take more money from its bank account than it holds; interest only on the amount overdrawn	Learn it
Debt factoring: selling unpaid customer invoices to a factoring company for immediate cash, less a fee	Learn it
Leasing: renting an asset for a fixed period; the leasing company keeps ownership	Learn it

Fact or formula	Status
Hire purchase: a deposit and fixed instalments, with ownership passing to the buyer after the final instalment	Learn it
Venture capital: risk capital for a small, fast-growing business, given in exchange for part-ownership	Learn it
Debentures: long-term loans to a company from investors, with fixed interest, a set repayment date and no vote	Learn it
Government grant: money from the government for a business or project, which usually does not have to be repaid	Learn it
Factors in the choice of source: cost, flexibility, need to keep control, the use the money is put to, level of existing debt	Learn it
Total cost of hire purchase = deposit + instalment $\times$ number of instalments	Learn it
Total cost of leasing = lease payment $\times$ number of payments	Learn it
Months before leasing has cost as much as buying = purchase price $\div$ monthly lease payment	Learn it
Interest for one year = amount borrowed $\times$ annual interest rate	Learn it

How to do it

We have tagged 37 questions on this topic (2021–2026), on Papers 1 and 2. One of them only uses finance as background, with no part on this topic, so 36 are counted below. 8 have parts of more than one type, so the counts add up to 44.

Question type	Questions
Evaluate whether a source (or which of two sources) is most appropriate	8
Analyse the benefits of a named source (no case)	7
Define or explain the term for a source of finance	7
Explain one advantage, disadvantage or reason for using a source	6
Explain, analyse or evaluate the factors that influence the choice of source	6
Analyse one advantage and one disadvantage of a source in a case	5
Suggest and explain or analyse suitable sources for a stated need	4
Calculate the total cost of a finance option	1

The marks are for four skills: **K** (knowledge: a correct point or definition), **App** (application: using the business or industry in the question), **An** (analysis: a chain of causes and consequences) and **Eval** (evaluation: a supported judgement). Below, (K), (App), (An) and (Eval) after a sentence show the mark it earns.

1. Evaluate whether a source (or which of two sources) is most appropriate (8 questions)

The [12] essay: on Paper 1 Section B it names a source and a type of business and asks whether that source is the best way to fund its growth or a purchase; on Paper 2 (d) it puts two options from the case side by side (a loan against an investor who wants part of the business, leasing against selling an old machine). Marks: 2 K, 2 App, 2 An, 6 Eval. Before 2022 the same task was set as "recommend ... justify" for 11 marks.

1. **K**: say what the named source is and how it works, and name one or two realistic alternatives.
2. **App**: use the business type or case all the way through: what it needs the money for, how much, its legal form, its profits and existing debts, its owners' wishes.
3. **An**: build chains for the named source, **for and against**, then for an alternative:
 - cost: interest or fees → higher costs → lower profit → less to reinvest; or no interest → costs stay low;
 - control: shares or venture capital → owners' stake diluted → investors outvote them or take a share of every year's profit;
 - repayments against cash flow: fixed monthly repayments → a bad month still has to be paid → cash-flow strain;
 - existing debt: already borrowing heavily → lenders see more risk → higher interest or a refusal;
 - fit to the use: a building suits a mortgage or retained earnings; equipment that dates quickly suits leasing.
4. **Eval**: decide, **for this business**, whether the source is the most appropriate, and say what it depends on: the amount and what it is for, how long it is needed, the legal form and size, how much debt it has already, how strongly the owners want control, interest rates, how profitable it is. A strong line: a **mix** of sources is often better than one.

Analysing **two** sources and comparing them is the easiest route to evaluation. Don't list every source in the syllabus: that becomes description, not argument.

2. Analyse the benefits of a named source (no case) (7 questions)

Paper 1 Section B (a) [8]: two benefits (or advantages) of a source the question names (an internal source, sale and leaseback, a grant, an overdraft, debt factoring, micro-finance). Each benefit is worth 4: **1 K + 1 App + 2 An**.

1. **K**: name a benefit that is true of this source: quick to arrange, no interest, no repayment, no loss of control, no security needed, keeps use of the asset, flexible, debt not increased.
2. **App**: explain it, or give a business example of it working (a hotel selling and leasing back its building to pay for a refurbishment).

3. **An**: take the benefit two steps further to a consequence for the business: no interest → lower costs → higher profit, or more cash for investment → faster growth. One link is limited (1); two or more links are developed (2).

Write about the **benefits**, not about how the source works or why it is given out; one line of description is enough. Analyse **two** different benefits, clearly separated ("The first benefit is ... The second benefit is ...").

3. Define or explain the term for a source of finance (7 questions)

- Paper 1 [2]: a precise definition with the **key feature** that makes it that source. One feature alone earns 1. Examples: a government grant is money from the government (1) that normally does not have to be repaid (1); venture capital is investment in a risky small business (1) given in return for a share of the ownership (1). Related terms set in the same place: **liquidation** (selling a company's assets to pay its creditors; "bankruptcy" is not the same thing) and **bankruptcy** (from the previous topic).
- Paper 2 [3] "explain the term": 1 K for the meaning, then 2 App: one for a further detail or example, one for a fact from the case (working capital: current assets minus current liabilities (K), the money that pays wages and suppliers (App), which the case business is short of after its expansion (App)).

4. Explain one advantage, disadvantage or reason for using a source (6 questions)

Usually [3]: 1 K + 2 for developing the point (on Paper 2, the second of these must use the case). The older [5] version asks for the advantages (plural) to one kind of business.

1. **K**: one advantage or disadvantage that is true of the source.
2. **Explain**: why it matters, the effect it has.
3. **Context** (Paper 2): a fact from the case: the business's lack of savings, its new status, its seasonal sales, the figures given.

Ready-made points to develop:

- **Retained earnings**, advantages: no interest, so costs stay down; quick, with no lender to persuade; no new owners; can be spent on anything.
- **Trade credit**, disadvantages: the discount for paying early is lost; paying late damages relations, and the supplier may stop credit or deliveries; it brings in no new money, only time.
- **Hire purchase**, advantages: no large upfront payment; fixed instalments make budgeting easier; the business owns the asset at the end.
- **Overdraft**, reasons to use one: covers a short gap until customers pay; available at once; interest only on what is used.

Make sure the point is on the right side: a disadvantage offered as an advantage (such as HP interest) earns nothing.

5. Explain, analyse or evaluate the factors that influence the choice of source (6 questions)

Three sizes: a Paper 2 [3] explaining one factor for the case business; an [8] analysing two factors (1 K + 1 App + 2 An each), generic or for a case purchase; a Paper 2 [12] judging which factor matters most for a case. A related essay asks what an investor such as a venture capitalist weighs before putting money in.

1. **K**: name a **factor**, not a source: cost, flexibility, need to keep control, the use or amount, existing debt; also the term, the legal form, the trading record, cash flow, risk.
2. **App**: tie it to the business: its legal form, the size of the purchase, its savings, its forecast cash balance, its debts.
3. **An**: show how the factor pushes the business **towards or away from** a source: a start-up with no record → banks reluctant → relies on savings, crowdfunding or micro-finance; a company that can sell shares → owners' stake diluted → may prefer a loan to keep control; a short cash gap → an overdraft or trade credit is enough.
4. **Eval** (12 marks): decide which factor is **most** important for this business and why, compared with at least one other.

The question is about **factors**. Answers that only recommend a source score poorly; mention sources only to show the effect of a factor. For the investor's view, the factors are the investor's: risk, growth potential, the quality of the management, the likely return and how they will get their money out.

6. Analyse one advantage and one disadvantage of a source in a case (5 questions)

Paper 2 (c) [8]: for each side, **1 K + 1 App + 2 An**. Overdrafts, crowdfunding, leasing and working capital have been set.

1. **K**: one advantage and one disadvantage, each true of the source (it need not be unique to it).
2. **App**: use the case: what the money is for, the amounts, the business's position.
3. **An**: a chain of two or more links on each side, ending in an effect on profit, cash flow, survival or the business's plans. A balanced chain (the point and its limit) also counts as developed.

Keep the focus on the **source**. Analysing why the case business's growth is good scores nothing here; analysing what the source does to its costs, cash and control does. Where the case gives numbers (a lease fee against a purchase price), use them.

7. Suggest and explain or analyse suitable sources for a stated need (4 questions)

Paper 2 (c) [8] asks for two sources for a large purchase in the case (machinery, a new shop); Paper 1 asks you to explain one external source [3] or the internal sources a business could use to grow [5].

1. Choose sources that are **possible for this legal form** and **suit the use**: a mortgage for premises; a loan, leasing or HP for machinery; new partners or becoming a company for a partnership; selling unused assets if it has any.

2. For each, explain **how it works** (K, and the first explanation mark): a 3-mark answer needs a correct description, such as "debt factoring: the business sells its unpaid invoices to a factor for most of their value now, and the factor keeps a fee".
3. Apply it to the case (the amount, the legal form, existing debt, the cash balance) and analyse a benefit and a drawback.
4. For "internal sources", give **internal** ones only (no loans or shares), each explained, plus an example of the growth it pays for.

8. Calculate the total cost of a finance option (1 question)

Paper 2 (b)(i) [3]: formula (1), a working stage such as the cost per year or the number of payments (1), the answer (1).

1. Write the formula in words: total HP cost = deposit + monthly instalment × number of months.
2. Count the payments: years × 12 for monthly payments.
3. Multiply, add any deposit, and give the units (dollars).

An arithmetic slip still earns the method marks if the working is shown, so always show it. Use the result in later parts: the extra paid over the cash price is the cost of spreading the payments.

Worked examples

Example 1

Lumen Dental is a partnership of two dentists. It wants a new X-ray unit with a cash price of 36,000 dollars. The supplier also offers hire purchase: a deposit of 3,000 dollars, then 48 monthly instalments of 850 dollars. The partners' savings were used to open the clinic two years ago.

- (a) Calculate the total cost of buying the X-ray unit on hire purchase. [3]
 - (b) Calculate how much more than the cash price this is, as a percentage of the cash price. [2]
 - (c) Explain one advantage for Lumen Dental of using hire purchase. [3]
- (a) Total cost = deposit + instalment × number of instalments (1).

Instalments: $850 \times 48 = 40800$ dollars (1).

Total: $3000 + 40800 = 43800$ dollars (1).

(b) Extra cost: $43800 - 36000 = 7800$ dollars (1). As a percentage: $\frac{7800}{36000} \times 100 = 21.7\%$ (1).

(c) Hire purchase avoids a large payment upfront (K). Lumen Dental needs to pay only 3,000 dollars now instead of 36,000 dollars, which matters because the partners' savings went into opening the clinic (App). The rest is paid in 48 fixed instalments of 850 dollars, which the clinic can budget for and pay out of the fees the

new X-ray unit helps it earn, and it owns the unit after the last instalment (App).

Example 2

(a) Define the term debentures. [2]

(b) Kestrel Motors is a car-repair garage that owns its workshop. It wants 90,000 dollars to open a second workshop in a nearby town. Explain how Kestrel Motors could use sale and leaseback to raise this money. [3]

(a) Long-term loans to a company from investors (1), which earn a fixed rate of interest and are repaid on a set date, without giving the lenders any vote (1).

(b) Sale and leaseback means selling a non-current asset the business still needs and renting it back (K). Kestrel Motors could sell its workshop to a property investor and sign a long lease on it, so it receives the building's value as cash but its mechanics go on repairing cars in the same workshop without moving (1). The cash would pay the 90,000 dollars for the second workshop, while the yearly rent becomes a new fixed cost that the extra repair work from the second workshop must cover (1).

Example 3

Tidepool Games is a partnership of two designers who have created a new board game. Printing the first 2,000 copies will cost 12.50 dollars each. They plan to raise the money on a crowdfunding website, which keeps a fee of 8% of the money raised. Backers who pledge 30 dollars receive a copy of the game when it is printed. The partners have no business record and a bank has refused them a loan.

Analyse one advantage and one disadvantage to Tidepool Games of using crowdfunding as a source of finance. [8]

Working (not asked for, but strong application): print cost $2000 \times 12.50 = 25000$ dollars. After the fee, the partners keep 92% of what is raised, so they need $25000 \div 0.92 = 27174$ dollars, from $27174 \div 30 = 905.8$, so 906 backers.

Advantage. Crowdfunding raises money from many small backers instead of one lender (K). The bank has refused Tidepool a loan because it has no trading record, but backers judge the game itself, so 906 people pledging 30 dollars each could provide the 25,000 dollars it needs to print (App). Because the backers are paid in games, not in interest or shares, the partners keep full ownership (An) and have no monthly repayments to meet, so every dollar from later shop sales can go into marketing and a second print run instead of servicing a loan (An).

Disadvantage. If the campaign misses its target, the business usually receives nothing (K). Tidepool must attract over 900 backers just to cover printing and the 8% fee, which is a lot for two unknown designers (App). If it falls short, the printing cannot go ahead, and the time spent on the campaign is wasted (An); worse, the game's design has been on public view for weeks, so a larger publisher could bring out a similar game first and take the market Tidepool had identified (An).

Each side earns K + App + two links of analysis: $2 K + 2 App + 4 An = 8$.

Example 4

Harbour Ferries Ltd is a private limited company owned by one family. It runs ferries between islands and made a profit of 600,000 dollars last year. It already owes 1.5 million dollars on a loan for its older ferry. It needs 2 million dollars for a new, larger ferry, which it expects to use for 20 years. It has two offers:

- **Option A:** a ten-year bank loan of 2 million dollars at 8% interest a year, repaid in equal yearly amounts of 200,000 dollars;
- **Option B:** a venture capital firm will provide the 2 million dollars in exchange for 35% of the company's shares and a seat on the board.

Evaluate which option Harbour Ferries Ltd should choose. **[12]**

Knowledge. A bank loan is a fixed sum borrowed for a set period and repaid with interest; the lender gets no share of the ownership (K). Venture capital is investment in a growing business in return for part-ownership; the investor shares in the profits and in decisions (K).

Option A: the loan. In the first year the interest is $2000000 \times 0.08 = 160000$ dollars, and with 200,000 dollars of the loan repaid as well, the cash going out is $160000 + 200000 = 360000$ dollars (App). That is more than half of last year's 600,000 dollars profit (App). The family keeps full control, which matters in a family company (An). But Harbour Ferries already owes 1.5 million dollars, so it would owe 3.5 million dollars in total: a stormy season or a rise in fuel prices could leave it unable to meet repayments, and the bank could take the ferry it secured the loan on (An). The interest also falls each year as the loan is repaid, and the ferry will still be earning for ten years after the loan ends (An).

Option B: venture capital. There are no repayments and no interest, so cash flow is safer in a bad season (An). But the investor would own 35% of the company: on last year's profit, its share is $600000 \times 0.35 = 210000$ dollars a year, for as long as it holds the shares, not just for ten years (App). The family would also lose some control: a board member who wants a high return and a sale of their shares within a few years may push for faster growth or a sale of the company (An).

Judgement. The loan looks better for Harbour Ferries if its profits are steady: its real cost is the interest, 160,000 dollars in the first year and only $1000000 \times 0.08 = 80000$ dollars once half the loan is repaid, which is less than the investor's 210,000 dollar yearly share of profit; the family keeps control; and the ferry is a long-lived asset that suits long-term borrowing (Eval). The risk is the combined 3.5 million dollar debt for a business whose income depends on the weather and tourism; if its profits swing widely, the safer choice is venture capital, or a mix: perhaps a smaller loan with part of the price paid from retained earnings (Eval). So it depends on how stable its 600,000 dollar profit is, how fast the old loan is being repaid, and how much the family values keeping the company to itself. On balance, a family firm with a long-lived asset and steady trade should take the loan, but only if it can show it will still meet 360,000 dollars of repayments in a poor year (Eval).

The marks: 2 K, 2 App, 2 An, and 6 Eval for a supported judgement in the context of this family ferry company that compares both options and says what the decision depends on.

Common mistakes

- **Not knowing what sale and leaseback is.** Many answers described ordinary leasing, or just selling an asset. The point is that the business sells the asset **and keeps using it** by renting it back (June 2021).
- **Mixing up leasing and hire purchase.** A leased asset is never owned, and the payments are a rental fee, not interest; with HP the business owns the asset at the end (June 2021).
- **Getting the overdraft wrong.** Defining it as a loan, saying it is interest free, or using it for long-term needs such as starting up or buying equipment (November 2021, June 2023). "Interest must be paid" is not a disadvantage special to an overdraft: write about the high rate, or the bank's right to call it in.
- **Recommending a source when the question asks for factors.** If the question asks what **influences** the choice, analyse the factors (cost, control, the use, debt); naming the best source earns little (November 2021, March 2023, June 2023).
- **Listing every source.** Essays that run through the whole syllabus list become description with no argument. Pick the two most suitable for the case and compare them (March 2021, June 2022).
- **Unsuitable matches.** An overdraft or crowdfunding to buy a factory; a share issue as a "quick" source. Long-term assets need long-term finance (June 2022).
- **External sources in an internal-sources question.** Loans and share issues are external. Retained earnings, sale of assets, sale and leaseback, owners' savings and working capital are internal (November 2022).
- **Describing instead of analysing.** Long explanations of how a source works, or why grants are awarded, leave no room for its **benefits**, which is where the marks are (March 2022, June 2023).
- **Confusing micro-finance with crowdfunding,** or saying micro-finance does not have to be repaid: it is a small loan (June 2021).
- **Drifting off the source.** In a crowdfunding question, analysing why growth is good for the business, instead of what crowdfunding does, is not rewarded; disadvantages of newer sources are often weak, so learn them (November 2022).
- **Misreading the case data.** Read who pays whom: a business that **leases** a machine pays the fee; it does not receive it (November 2021).
- **Generic answers on Paper 2.** A factor or source explained well but not applied to the case business is capped at the knowledge mark (June 2023).

How to get the marks

- **Command words.** *Define*: the meaning plus its key feature (2 marks). *Explain*: a point, then why or how, with the case if there is one. *Calculate*: formula, working, answer. *Analyse*: one or two points, each developed through a chain to a consequence; no judgement needed. *Evaluate*: both sides, then a decision for the business in the question, saying what it depends on.
- **Be precise about the source.** Each source has a feature that defines it: an overdraft goes below zero up to a limit; HP ends in ownership; a lease never does; a grant is normally not repaid; venture capital buys part-ownership; factoring sells invoices for a fee. Examiners look for that feature.

- **A point must be true of the source.** It need not be unique to it, but a disadvantage written as an advantage, or a feature of a different source, scores nothing.
- **[3] explain one advantage or disadvantage:** 1 for the point, 2 for developing it; on Paper 2, one of those must come from the case.
- **[8] analyse two benefits, or one advantage and one disadvantage:** label each one; give K, App and a chain of at least two links each. Finish each chain with an effect on profit, cash flow, control or survival.
- **[12] evaluate:** 2 K, 2 App, 2 An, 6 Eval. The top band needs a supported judgement **in context:** about this business, comparing at least two options, saying what the answer depends on. Judgements can come throughout, not only at the end.
- **Use the numbers.** A total HP cost, the months before leasing costs more than buying, a year's interest or a share of profit given away is strong application, and makes your judgement concrete.
- **Use the legal form.** It decides what is possible: no shares for a sole trader or partnership; limited liability helps a company attract investors; a plc can sell to the public.

Quick check

1. Classify each source as internal or external, and as short term or long term: (a) retained earnings, (b) debt factoring, (c) a mortgage, (d) sale and leaseback, (e) trade credit, (f) share capital.
2. A plumbing business can buy a van for 19,800 dollars or lease one for 450 dollars a month. Calculate how many months of leasing would cost the same as buying, and the total paid over a 3-year lease.
3. A florist buys a refrigerated display on hire purchase: a deposit of 1,200 dollars and 24 monthly payments of 310 dollars. The cash price is 7,500 dollars. Calculate the total cost and the extra paid over the cash price.
4. Define the term mortgage. **[2]**
5. A taxi firm leases its 20 cars instead of buying them. Explain one disadvantage of leasing for the taxi firm. **[3]**

Answers

1. (a) Internal, long term. (b) External, short term. (c) External, long term. (d) Internal, long term. (e) External, short term. (f) External, long term.
2. $19800 \div 450 = 44$ months. Over a 3-year lease: $450 \times 36 = 16200$ dollars, less than the purchase price, but the business owns no van at the end.
3. Total cost = $1200 + 24 \times 310 = 1200 + 7440 = 8640$ dollars. Extra paid = $8640 - 7500 = 1140$ dollars.
4. A long-term loan to buy land or buildings (1), secured on that property, which the lender can take if repayments are not made (1).
5. Over the years, leasing usually costs more than buying the cars outright (K): the firm keeps paying lease fees for every car for as long as it uses it (1), and at the end of the lease it owns no cars that it could sell or keep using, so it must take on a new lease, and its costs never fall the way they would once bought cars were paid off (1).

Past questions to try

- **9609/23/O/N/24 Q1**: part (b), the total cost of a hire purchase deal and one advantage of hire purchase in the case.
- **9609/13/O/N/23 Q3**: defining venture capital and explaining a drawback of trade credit.
- **9609/23/M/J/23 Q2**: part (c), choosing two sources for a large purchase by a business with an unusual legal form.
- **9609/23/O/N/23 Q1**: part (d), judging whether a bank loan is the best way to pay for a young business's growth.