

Business finance: needs and sources

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What you need to know

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

1. **Why businesses need finance.** Explain the main reasons: **start-up capital**, **capital for expansion** and **extra working capital**.
 2. **Short-term and long-term needs.** Tell a short-term need (for less than about a year, such as paying wages before customers pay) from a long-term need (money tied up for years, such as a new building).
 3. **Internal and external sources.** Explain sources from inside the business (such as retained profit) and from outside it (such as a bank loan), with examples.
 4. **Short-term and long-term sources.** Explain short-term sources (such as an overdraft) and long-term sources: borrowing (**debt**) or selling shares (**equity**).
 5. **Alternative sources of capital.** Explain **microfinance** and **crowdfunding** and why they matter.
 6. **Choosing a source.** Explain the factors a business weighs up: size and legal form, amount required, length of time, existing loans and others.
 7. **Recommend a source.** Recommend and justify the most suitable source or sources for a business in a given situation.
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Understand it

Why businesses need finance

Finance is the money a business raises to pay for what it needs. There are three main reasons.

- **Start-up capital:** the money needed to set the business up before it begins trading. A new business must buy premises, equipment and its first inventory before it earns anything.
- **Capital for expansion.** Growing needs money for a new branch, a bigger factory, vehicles, machinery or technology, a new product or a takeover: large sums spent now that pay back over many years. Replacing worn-out machinery fits here too.
- **Working capital:** the money available for day-to-day spending (current assets minus current liabilities). It pays wages, rent, bills and suppliers while the business waits for customers to pay. Extra is needed when sales dip for part of the year, when output rises (materials are bought before the goods are sold) or when

customers pay late.

Short-term and long-term finance needs

	Short-term need	Long-term need
How long	paid back within about a year	paid back over several years
What it pays for	wages, materials, inventory, bills, a gap in cash flow	buildings, machinery, vehicles, expansion, a takeover
Example	a toy shop buying extra inventory before a festival, paid for by the festival's sales	a farm buying a tractor it will use for ten years

The key rule is to **match the source to the need**. A tractor used for ten years should not be paid for with money due back next month, or the farm runs short of cash; and there is no point paying interest for five years on money needed for six weeks.

Internal sources of finance

Internal sources come from within the business. Nobody outside has to agree, so they are usually quick, and there is no interest.

- **Retained profit:** profit kept in the business after tax and payments to the owners, used to fund the business. It is never repaid, but a new business has none, a small one may not have enough, and the owners receive less, which may put them off investing.
- **Sale of non-current assets:** selling a building, vehicle or machine no longer needed. It can raise a large sum, but finding a buyer takes time and the asset is gone if needed later.
- **Running down inventory:** selling goods held in stock instead of buying more. It releases cash quickly, but sudden orders may be missed.
- **Owner's savings** (sole traders and partnerships): quick, no interest and no repayment, but the owner may not have enough, risks losing it if the business fails, and loses the interest it would earn in a bank.

External sources of finance

External sources come from outside the business. They can usually raise more than internal sources, but most have a cost: interest, fees, conditions or a share of the business.

Source	What it is	Advantages	Disadvantages
Bank loan	a fixed sum borrowed for a set time, repaid with interest in instalments	large amounts; fairly quick; repayments can be planned; owners keep control	interest raises costs; must be repaid even if sales fall; the bank may want collateral (an asset it can take if the loan is not repaid)

Source	What it is	Advantages	Disadvantages
Bank overdraft	permission to take more out of the bank account than is in it, up to a limit	flexible: interest only on what is used; quick to arrange	interest often high and variable; the bank can ask for it back at short notice; short-term needs only
Trade credit	a supplier lets the business pay some time after receiving the goods, often 30 or 60 days	effectively an interest-free loan; goods can be sold before they are paid for	late payment harms the relationship, so credit or discounts may be withdrawn; a new business may not be offered it
Issue of shares	a limited company sells new shares to investors	never repaid; no interest; very large sums	limited companies only; existing owners lose some control; shareholders expect dividends when there is profit
Leasing	renting an asset, such as a vehicle, for a monthly payment	no large sum at the start; maintenance often included; can switch to newer models	costs more in total than buying; never owned, so nothing to sell at the end
Hire purchase	a deposit, then monthly payments; the asset is owned after the last payment	spreads the cost; the asset is owned in the end	total paid is more than the cash price; the asset can be taken back if payments are missed
Government grant	money given by the government, often to start-ups or areas of high unemployment	not repaid; no interest	hard to get; conditions on how or where it is used; applying takes time

Other external sources are a **mortgage** (a long-term loan secured on land or buildings), **debentures** (long-term loans a limited company raises from investors) and loans from family or friends. A grant is a gift, never repaid. In leasing, the business rents an asset **from** a leasing company; it does not rent its own assets out.

Short-term and long-term sources, debt and equity

- **Short-term sources:** overdraft, trade credit, short-term loans, running down inventory. Use them for working capital.
- **Long-term sources:** bank loans, mortgages, shares, debentures, retained profit, sale of non-current assets, grants. Leasing and hire purchase usually run for one to five years, for vehicles and machinery.

Long-term finance is of two kinds. **Debt** is borrowed money that must be repaid with interest (loans, mortgages, debentures): the owners keep control, but repayments are due whatever happens to sales, and a business that already owes a lot finds it harder to borrow more. **Equity** is money from selling a share of the business (issuing shares): never repaid and no interest, but the new owners share the profit and the control.

	Internal from inside the business	External from outside
Short-term (up to 1 year)	Sell off spare inventory	Bank overdraft Trade credit Short-term bank loan
Long-term (over 1 year)	Retained profit Sale of non-current assets Owner's savings (sole traders and partnerships)	Bank loan or mortgage Issue of shares (limited companies only) Debentures Leasing and hire purchase Government grant
Alternative sources	—	Microfinance Crowdfunding

Alternative sources: microfinance and crowdfunding

Many people with a good idea cannot get a bank loan: they have no trading record, no credit history and no collateral. Two newer sources help them.

Microfinance is the lending of small amounts of money to people on low incomes and to very small businesses that banks will not lend to. It needs no collateral or credit history and little paperwork. But the amounts only suit a stall or a few tools, interest rates are often high because the lender takes a big risk, and repayment terms can be strict.

Crowdfunding is raising money from a large number of people, each giving a small amount, usually through a website. There is no fee at the start and usually no interest, and the campaign tests public interest and gives free publicity. But the target may not be reached (on many platforms the money then goes back to the backers), the platform may reject the idea, and rivals can copy an idea shown online.

Why they are important: they finance entrepreneurs that banks turn down, so more businesses start, creating jobs and income, especially in poorer areas.

Factors a business considers when choosing a source

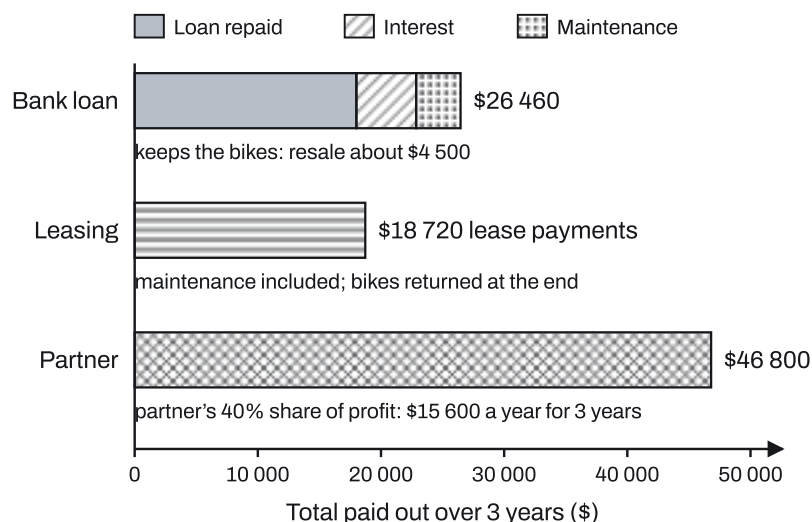
Factor	How it affects the choice
Purpose	a non-current asset needs long-term finance; working capital needs short-term finance
Amount required	a small sum can come from an overdraft, savings or microfinance; a large one needs a loan, shares or years of retained profit
Length of time	weeks suit an overdraft or trade credit; years suit a loan, a mortgage or shares
Size and legal form	only limited companies can issue shares; large businesses borrow more easily and more cheaply, as lenders see less risk
Existing loans	a business that already owes a lot may be refused more, or charged higher interest

Factor	How it affects the choice
Cost	interest, fees and dividends raise expenses and cash outflows
Control	owners who want to keep control avoid selling shares or taking a partner
Collateral	a start-up may have no asset to offer, or the owner may risk losing a house
Urgency	an overdraft or retained profit is quick; a share issue or grant takes months
Trading record	a new business may be refused loans or trade credit

In an answer, a factor must lead to a **choice**: "the amount required is large, so the owners' savings may not be enough and a bank loan may be needed".

Recommending a source

1. **Work out the need**: what the money is for, how much and for how long.
2. **Rule out what cannot work**: a sole trader cannot issue shares, a start-up has no retained profit, an overdraft cannot fund a factory, a business deep in debt may be refused a loan.
3. **Compare what is left**, with a consequence for each: cost (work out the interest or total paid when figures are given), risk, control, speed.
4. **Choose**, with a reason linked to the business, and **say why the others were rejected**. A combination, such as savings for part and a loan for the rest, is often best.



The chart is from Example 4: the partner costs far more than either other option, and leasing pays out the least, but only the loan leaves Kofi owning the bikes.

Key facts and formulas

This topic has no formula list in the exam. "Learn it" means you must remember it.

Fact or formula	Status
Start-up capital: the money needed to set the business up before it begins trading	Learn it
Working capital: the money available for day-to-day spending (current assets minus current liabilities)	Learn it
Retained profit: profit kept in the business after tax and payments to the owners, used to fund the business	Learn it
Internal sources: retained profit, sale of non-current assets, running down inventory, owner's savings	Learn it
Short-term external sources: overdraft, trade credit; long-term: bank loan, mortgage, shares, debentures, leasing, hire purchase, grants	Learn it
Debt: borrowed money that must be repaid with interest; equity: money from selling a share of the business	Learn it
Microfinance: the lending of small amounts of money to people on low incomes and to very small businesses that banks will not lend to	Learn it
Crowdfunding: raising money from a large number of people, each giving a small amount, usually through a website	Learn it
Factors in choosing a source: purpose, amount, length of time, size and legal form, existing loans, cost, control, collateral, urgency	Learn it
Interest on a loan at a flat rate = amount borrowed $\times \frac{\text{rate}}{100} \times \text{number of years}$	Learn it
Total repaid on a loan = amount borrowed + interest	Learn it
Total paid by hire purchase = deposit + number of payments $\times$ each payment	Learn it

How to do it

We have tagged 42 questions on this topic (2021–2026), on Paper 1 and Paper 2. Three of them (Paper 1, June 2023, Variant 2; Paper 1, March 2023; Paper 1, November 2022, Variant 3) have parts of two types, so the counts add to 45.

Question type	Questions
Explain sources of finance a business could use	9
Explain factors to consider when choosing a source of finance	9
Advantages and disadvantages of one named source	8

Question type	Questions
Judge whether one source is best	8
Compare two or three named sources and recommend one	5
Explain why a business needs finance (short-term and long-term)	5
Define a finance term	1

The mark scheme codes are **k** (knowledge: a correct point), **app** (application: a detail from the case), **an** (analysis: a developed consequence) and **eval** (evaluation: a justified judgement).

Part	Marks	What earns them
Paper 1 "Define"	2	a full definition; a partial one gets 1
Paper 1 "Identify"	1	short, different points; only the first ones asked for are marked each
Paper 1 "Outline" (c)	4	each point: k + app
Paper 1 "Explain" (d)	6	each point: k + app + an
Paper 1 (e) "Do you think ...?" or "Explain two ... Which ...?"	6	2 k + 2 an + 2 eval; general, so no app
Paper 2 (a)	8	either four points × (1 + 1 explanation), or two points × (1 + up to 3 development, one of them in context)
Paper 2 (b) "Consider ... Which ...? Justify"	12	levels: applied discussion of every option, then a choice that says why the others were rejected

1. Explain sources of finance a business could use (9 questions)

Paper 1 (d), 6 marks: each of two sources earns k + app + an.

- Check the purpose and the business:** a long-term purpose needs a long-term source; shares only for limited companies; no retained profit for a start-up.
- Name the source** (k). "Borrowing" or "external finance" earns nothing.
- Tie it to the business** (app), with a detail that is not just a word from the question.
- Give an advantage of that source** (an): no repayment, no interest, a large amount, quick to arrange, no big sum at once. Don't define it.

Example for a bus company buying buses: "Leasing (k), paying a monthly charge for the 12 new buses instead of their full price at once (app), so cash is kept for fuel and wages and the leasing company handles maintenance (an)."

Variations you will meet:

- **External sources for a new factory (0450/12/F/M/26 Q3, part (d)):** a public limited company making beds. A share issue was applied to it being a public limited company; loans, grants, crowdfunding and leasing were also credited. Retained profit (internal) and an overdraft (short-term) did not fit.
- **Expanding a hotel owned by two partners (0450/12/F/M/25 Q1, part (d)):** retained profit, a bank loan, the partners' savings. Shares do not fit a partnership.
- **20 new delivery vehicles (0450/11/M/J/23 Q3, part (d)):** an overdraft is unlikely to cover them.
- **Start-up capital for a new window cleaning business (0450/12/M/J/22 Q4, part (d)):** savings, a bank loan, family. A start-up has no retained profit and cannot use debentures; drawbacks such as "loans must be repaid" did not answer it.
- **Paper 2 (a), four external sources (0450/23/M/J/25 Q3, part (a)):** 1 for each source, 1 for explaining it; no application. Explain the source, not what the money buys.
- **One internal and one external source as a business expands (0450/21/M/J/21 Q3, part (a)):** for example retained profit built up over many years, and a bank loan repaid over several years.
- **Internal sources only (0450/12/M/J/21 Q2, part (c), identify four; 0450/13/O/N/22 Q1, part (c), outline two for a fishing business):** external sources earn nothing.
- **Two sources for growth, then choose (0450/12/F/M/23 Q3, part (e)):** see type 4.

2. Explain factors to consider when choosing a source of finance (9 questions)

Paper 1 (d), 6 marks: each of two factors earns k + app + an. Paper 2 (a), 8 marks: two factors developed, or four explained briefly.

1. **Name a factor (k):** amount, time, purpose, size and legal form, existing loans, cost, control, collateral, urgency. A source is not a factor.
2. **Tie it to the business (app):** figures from a statement of financial position work well.
3. **Say how it changes the choice (an):** which sources it rules in or out, or what it does to costs.

Example for a printing company: "Existing loans (k): it already owes \$2 million to the bank (app), so the bank may refuse to lend more or charge higher interest, and it may have to issue shares instead (an)."

Variations you will meet:

- **A retailer buying 10 delivery vehicles, with a statement of financial position (0450/11/O/N/25 Q2, part (d)):** amount, existing borrowing (its non-current liabilities), time period, cost, legal form, collateral, control, urgency.
- **A timber business (0450/13/M/J/24 Q1, part (d)):** its non-current liabilities show existing debt; a large amount may not be available internally.
- **A public limited company shoe maker expanding (0450/12/F/M/21 Q1, part (d)):** the best answers explained amount and length of time; some wrote about which source to use instead.
- **Paper 2 (a), two factors for a private limited company (0450/21/M/J/24 Q4, part (a)):** 1 + up to 3 each, one in context, such as its legal form allowing a share issue, or owners not wanting to lose control.

- **Paper 2 (a), four factors** (0450/22/O/N/23 Q2, part (a), for expansion; 0450/23/O/N/21 Q4, part (a), general, no application): in 2021 the most popular were size and legal form, amount, time, cost and purpose, but only stronger answers explained how each affects the choice.
- **Identify two factors** (0450/12/F/M/24 Q3, part (b)): 1 mark each.
- **Is the amount the most important factor for a sole trader?** (0450/11/M/J/21 Q3, part (e)): many listed sources; the strongest argued a sole trader would care most about the cost of the finance and the time taken to repay it.
- **Why a new business could not get trade credit** (0450/13/M/J/21 Q1, part (c)): no trading record, so suppliers see a risk of not being paid.

3. Advantages and disadvantages of one named source (8 questions)

Paper 1 (c), 4 marks (k + app each), or (d), 6 marks (k + app + an each). Paper 2 (a), 8 marks: two advantages and two disadvantages, 1 + 1 each.

1. **Make every point specific to that source:** interest and repayment for loans, control for shares, "may not be enough" for retained profit, savings or microfinance.
2. **Develop each point:** higher expenses, lower profit, cash-flow problems, losing assets, a delayed plan.
3. **Use a different case detail for each point** when application is available.

Variations you will meet:

- **A bank loan, general** (0450/21/M/J/25 Q3, part (a)): large amounts, choice of repayment period, fixed repayments easy to plan, control kept; interest, collateral, repayments hitting cash flow, a variable rate rising.
- **Retained profit for a partnership's new factory** (0450/22/F/M/24 Q4, part (a)): no repayment or interest, available at once; but after only 2 years of trading there may not be enough, and the owners get less.
- **Microfinance for a new bookseller** (0450/11/O/N/24 Q2, part (c)): no credit history or collateral, less paperwork; small amounts, high interest.
- **Crowdfunding for a new cake business** (0450/12/O/N/23 Q1, part (d)): one advantage and one disadvantage, explained.
- **A government grant for a car repair business** (0450/13/O/N/21 Q2, part (c)): no interest or repayment, but rules on its use. Many wrongly thought grants are repaid.
- **New shares to fund a takeover** (0450/12/O/N/21 Q4, part (d)): no interest, but loss of control. Shares are not quick, do not create revenue, and dividends are not compulsory.
- **Two advantages of external finance** (0450/13/M/J/25 Q4, part (b)): quicker, larger amounts, internal funds kept for other uses, advice from the provider. Naming sources, or why the money is needed, scored nothing.
- **Problems of a high level of debt** (0450/13/O/N/22 Q1, part (d)): harder to borrow more, interest costs, cash-flow problems. Reasons for the debt, or solutions, did not answer it.

4. Judge whether one source is best (8 questions)

Paper 1 (e), 6 marks, general (no application): 2 for points, 2 for development, 2 for a justified decision.

1. **One or two developed points about the named source.**
2. **One developed point about an alternative.**
3. **Decide**, comparing the two or saying **when** the source would be best and when not. The decision must follow from the analysis, not repeat it.

Variations you will meet:

- **A bank loan as start-up capital (0450/12/M/J/25 Q3, part (e)):** quick, can raise the full amount; but interest, repayment and collateral a start-up may lack. Compare with savings, family, an overdraft, a grant or crowdfunding. Why finance is needed was off the point.
- **Retained profit for expansion: advantages greater than disadvantages? (0450/11/M/J/25 Q4, part (e)):** no repayment or interest; but slow to build, maybe too little, less for owners. Bank loans were not relevant, and profit is not cash.
- **Crowdfunding for a start-up (0450/13/O/N/24 Q2, part (e)):** no fee at the start and a test of public interest, against the risk of falling short or being copied.
- **Owner's savings for a start-up (0450/11/O/N/23 Q1, part (e)):** no interest or repayment, against the owner having too little and risking personal money.
- **Debt or equity for a private limited company's long-term finance (0450/12/M/J/23 Q4, part (e)):** control kept but interest and repayment, against no repayment but shared ownership.
- **New shares or a bank loan for a limited company's expansion (0450/11/O/N/21 Q4, part (e)):** the same trade-off applied to one growth project: a large sum without repayment, against keeping control.
- **Leasing for a small business's new vehicle (0450/12/F/M/22 Q3, part (e)):** stronger answers developed not having to pay for maintenance; some wrongly thought the business was leasing vehicles out.
- **Two sources for growth, then the best (0450/12/F/M/23 Q3, part (e)):** name long-term sources; evaluation went only to the strongest answers, which weighed one against the other for a growing business.

5. Compare two or three named sources and recommend one (5 questions)

Paper 2 (b), 12 marks, levels.

1. **For each source**, advantages and disadvantages **for this business and purpose**, each with a consequence.
2. **Use the figures:** interest, total cost or monthly payments.
3. **Recommend one** with a reason from the case, and **say why each other source was rejected**, without repeating earlier points.

Level 1 (1–4): sources outlined. Level 2 (5–8): at least one discussed in detail, in context, with some judgement. Level 3 (9–12): detailed discussion and a well-justified recommendation; the top of the band needs **every** source in detail and why the others were rejected.

Variations you will meet:

- **Overdraft or trade credit for working capital at a new flower shop (0450/22/O/N/25 Q3, part (b)):** an overdraft is quick and flexible but has interest, possibly high or variable, and may need collateral; trade credit is interest-free and the flowers can be sold before paying, but late payment risks the supplier's goodwill and discounts.
- **Owner's savings, microfinance or crowdfunding to start a furniture business (0450/23/M/J/24 Q2, part (b)):** a small sum suits microfinance; savings are quick but risk the owner's money; crowdfunding brings publicity but may fall short.
- **Leasing, a bank loan or retained profit for vehicles (0450/21/O/N/22 Q2, part (b)):** leasing includes maintenance but leaves nothing to sell; a fairly new business may not get a big loan even with low interest rates.
- **Crowdfunding, a bank loan or leasing for machinery (0450/22/O/N/21 Q2, part (b)):** say why interest matters (higher expenses, lower profit), not just that it is charged.
- **A 1-year loan, a 3-year loan or an inheritance for a franchise, with calculations (0450/23/M/J/21 Q4, part (b)):** stronger answers worked out each loan's interest and used it; stronger answers also saw that savings interest on the inheritance could cover a loan's interest.

6. Explain why a business needs finance (short-term and long-term) (5 questions)

Paper 1 (c), 4 marks: one reason for each type (k), tied to the business (app). Paper 2 (a), 8 marks: 1 per reason and up to 3 explaining it, one in context.

1. **Short-term:** day-to-day costs (wages, materials, bills), a cash-flow gap (a quiet season, late payers), materials bought before sales come in.
2. **Long-term:** expansion, new or replacement non-current assets, new technology, a new product, a takeover.
3. **Develop it:** what happens without the money (cannot operate, falls behind rivals) and what it achieves (more output, lower average costs).

Example for a hairdresser: "Short-term: to pay the two stylists in a quiet month (k + app), because unpaid stylists may leave and customers cannot be served (an). Long-term: to take over the shop next door and add four chairs (k + app), so more customers are served and revenue rises (an)."

Variations you will meet:

- **A café run by a sole trader (0450/22/F/M/26 Q3, part (a)):** one short-term and one long-term reason, explained. Some swapped the two.
- **A cookie business, two reasons not split by term (0450/21/O/N/24 Q4, part (a)):** replacing worn-out equipment, expansion, new products, working capital.
- **A small car repair business (0450/12/O/N/24 Q1, part (c)) and a multinational clothing manufacturer (0450/11/M/J/24 Q3, part (c)):** one reason of each type, applied.
- **A restaurant chain, "using an example" (0450/21/M/J/23 Q4, part (a)):** strong answers named a real need, such as a huge weekly wage bill or replacing ovens; vague mentions of debts scored little.

7. Define a finance term (1 question)

- **Define retained profit** (0450/12/M/J/23 Q4, part (a)), 2 marks: profit kept in the business after tax and payments to the owners, used to fund the business. A partial definition gets 1 mark.

Worked examples

Example 1

(a) Give one example of a short-term source of finance and one example of a long-term source of finance. [2]

(b) Identify two features of microfinance. [2]

(a) Short-term: a bank overdraft (1). Long-term: a mortgage (1).

(b) It lends small amounts of money (1). It does not need collateral from the borrower (1).

This is a general question, so no business is named. Each part earns 1 mark per point ($2 + 2 = 4$). Total 4 marks.

Example 2

BrightSmile is a dental clinic owned by two partners. It employs 6 staff. The partners want a new X-ray machine with a cash price of \$24 000. Their bank balance is low because many patients pay late. The supplier offers hire purchase: a deposit of \$4800, then 24 monthly payments of \$950.

(a) Calculate the total cost of buying the machine by hire purchase, and how much more this is than the cash price. Show your working. [2]

(b) Explain one way hire purchase would help BrightSmile's cash flow and one way it would reduce BrightSmile's profit. [6]

(a) $\text{Total} = 4800 + 24 \times 950 = 27\,600$ dollars (1). $\text{Extra cost} = 27\,600 - 24\,000 = 3600$ dollars (1), which is 15% of the cash price.

(b) Cash flow: the cost is spread out (k). The partners pay \$4800 now and \$950 a month instead of \$24 000 at once, which matters while patients are paying late (app); cash stays in the bank to pay the 6 staff and suppliers, so the clinic avoids a cash-flow problem (an).

Profit: it costs more than paying cash (k). BrightSmile pays \$3600 more than the cash price (app), and this extra charge is an expense, so the clinic's profit is lower than if it had paid cash (an).

Part (a) earns 1 mark for each step (2 marks); part (b) earns k + app + an for each point ($3 + 3 = 6$). Total 8 marks. The two applications use different details from the case (patients paying late, the \$3600 extra).

Example 3

A small manufacturing business wants to buy energy-saving machinery. Explain one advantage of a government grant and one advantage of a bank loan for this purchase. Which source should it choose? Justify your answer. [6]

A grant does not have to be repaid and has no interest (k). So buying the machinery adds nothing to the business's cash outflows, and all of the money saved on energy adds to its profit (an).

A bank loan can usually be arranged within weeks for the full price (k). The machinery is bought straight away, so the business starts saving on its energy bills at once instead of waiting months for a grant decision (an).

I think it should choose the grant if it qualifies, because over several years the interest and monthly repayments on a loan would cost a small business far more than a short wait (eval). But grants are not certain and come with conditions, such as spending the money only on approved equipment, so if the grant is refused or covers only part of the price, a loan for the rest is better than delaying the purchase (eval).

This is a general question, so no business is named and there are no marks for application: 2 k + 2 an + 2 eval = 6.

Example 4

Kofi runs a bicycle repair shop as a sole trader with 2 employees. Tourists keep asking to hire bikes, so he plans to buy 6 electric bikes at \$3000 each to hire out. He has only \$2000 in savings, kept for emergencies. His profit last year was \$30 000, and he expects the bikes to raise it to \$39 000 a year.

Option	Details
Bank loan	\$18 000 for 3 years at 9% a year on the amount borrowed; his house as collateral; maintenance about \$1200 a year; the bikes could be sold for about \$4500 after 3 years
Leasing	\$520 a month for 3 years for all 6 bikes, maintenance included; the bikes are returned at the end, and newer models can then be leased
A partner	a friend invests \$18 000 for 40% of the business's profit and a say in decisions

Kofi thinks leasing is the best of the three options. Do you agree? Justify your answer using suitable calculations. [12]

Bank loan. Interest is $18\,000 \times 0.09 \times 3 = 4860$ dollars, so Kofi repays $18\,000 + 4860 = 22\,860$ dollars, or $22\,860 \div 36 = 635$ dollars a month. With maintenance of $1200 \times 3 = 3600$ dollars, he pays out $22\,860 + 3600 = 26\,460$ dollars. He keeps control and owns the bikes, so after selling them he is down $26\,460 - 4500 = 21\,960$ dollars. But repayments are due even if tourists stop coming, and his house is at risk.

Leasing. Kofi pays $520 \times 36 = 18\,720$ dollars, with no large sum at the start and no collateral: $21\,960 - 18\,720 = 3240$ dollars less than the loan even after selling the bikes. Repairs cost him nothing, and he can switch to newer models, which tourists may prefer. But he never owns the bikes and is committed to \$520

every month.

A partner. No repayments or interest, and the partner may share the work. But the partner takes $40\% \times 39\,000 = 15\,600$ dollars a year, or $15\,600 \times 3 = 46\,800$ dollars over 3 years. Kofi would keep $39\,000 - 15\,600 = 23\,400$ dollars a year, $30\,000 - 23\,400 = 6\,600$ dollars less than he earns now without the bikes, and he would share decisions.

Judgement. I agree: Kofi should lease. It pays out the least, needs no collateral, and its monthly payment is $635 - 520 = 115$ dollars lower than the loan's, which helps his cash flow in quiet months. The partner is rejected because Kofi would end up worse off than now and lose some control. The loan is rejected because it costs more and risks his house on an untested idea. Its one strength is Kofi's skill: as a mechanic he could maintain the bikes himself, and then the loan would cost $22\,860 - 4\,500 = 18\,360$ dollars, only $18\,720 - 18\,360 = 360$ dollars less than leasing, not enough to justify risking his home.

All three options are discussed in detail, in context and with calculations, and the judgement says why each other option was rejected: **Level 3** (9–12 marks). Disagreeing and choosing the loan could also score well, arguing that his skills make maintenance nearly free and he ends up owning the bikes.

Common mistakes

- **A short-term source for a long-term need.** Reports in 2023, 2025 and 2026 all name this: an overdraft is not suitable for a factory, new vehicles or growth.
- **A source the business cannot use.** Shares are only for limited companies; a start-up has no retained profit, and debentures are not an option for it.
- **Internal when the question asks for external, or the reverse.**
- **Defining the source instead of explaining it.** Saying what crowdfunding is earns nothing; give an advantage of using it.
- **Vague words.** "Easy to get" or "higher cost" need a reason: "quicker to arrange than a share issue", "interest is added to each repayment". "Borrowing" is not a source; name it.
- **Weak application:** copying words from the question, such as "factory" in a question about a new factory, using the same case detail for both points, or describing how the source works instead of linking it to the business.
- **Mirror arguments.** "A loan has interest; retained profit has none" is one point made twice.
- **Mixing up profit, revenue and cash.** Retained profit is not revenue, and not the cash for day-to-day bills. Interest is an expense paid before profit is worked out, so profit is not used to pay interest.
- **Answering why the money is needed instead of how it is raised,** in questions about sources, factors or the advantages of external finance.
- **Naming sources when asked for factors.** "Bank loan" is not a factor; "amount required" is.
- **Swapping short-term and long-term reasons.** Wages are short-term; machinery is long-term.
- **Disadvantages when advantages are asked for,** or the reverse.
- **Thinking a grant must be repaid,** or that leasing means renting your own assets out.

- **Wrong ideas about shares:** issuing them is not quick, creates no revenue, and dividends are not compulsory.
- **Trade credit misunderstood:** it means paying the supplier later, not the supplier stopping supplies.
- **Discussing other sources when one source is named,** such as bank loans in a question about retained profit.
- **New points instead of development, and conclusions that repeat.** Without analysis there is no evaluation; a Paper 2 (b) recommendation needs a new reason and why the others were rejected.

How to get the marks

- **Define** (2 marks): the full idea, as in the definition of retained profit under type 7; a partial definition gets 1 mark.
- **Identify** (1 mark each): short, specific, different points; only the first ones count.
- **Outline, Paper 1 (c)** (4 marks): point (k) plus a case detail (app) each.
- **Explain, Paper 1 (d)** (6 marks): point (k), a case detail that is not just a word from the question (app), and the consequence (an). Use a different case detail for each point.
- **Paper 1 (e)** (6 marks): general, so no case details. Two developed points, then a decision that compares them and says **why**, or **when** the source would and would not be best.
- **Paper 2 (a)** (8 marks): if no business is named, four different points with one explanation each; if it is, develop each point in a chain of up to three steps, one about the business.
- **Paper 2 (b)** (12 marks): **every** option, both sides, for this business and purpose; calculate interest, totals or monthly payments when figures are given; then a recommendation with a reason from the case and why the others were rejected. Any option can score full marks if well justified.
- **"Justify your answer"** means a comparing reason: "a grant is never repaid, while a loan adds interest every month for years".
- Use the exact terms: **retained profit, working capital, overdraft, trade credit, collateral, debt, equity, microfinance, crowdfunding.**

Quick check

1. Is each source internal or external, and is it short-term or long-term? (a) Retained profit. (b) Trade credit. (c) Issuing shares. (d) Selling an unused warehouse. (e) Bank overdraft.
2. A gym borrows \$40 000 for 4 years at 6% a year on the amount borrowed. Calculate (a) the total interest, (b) the total repaid and (c) the monthly repayment, to the nearest cent.
3. A designer sets a crowdfunding target of \$15 000. After the 30-day campaign, backers have pledged \$11 400. (a) What percentage of the target was raised? (b) On an all-or-nothing platform, what happens next, and what does this tell the designer?
4. A delivery business plans to pay for a new van with its overdraft. Explain why this is not a good idea and suggest a better source.

5. A sole trader wants to raise \$50 000 by issuing shares. Explain why she cannot, and suggest two other sources she could use.

Answers

1. (a) Internal, long-term. (b) External, short-term. (c) External, long-term (equity). (d) Internal, long-term. (e) External, short-term.
2. (a) $40\,000 \times 0.06 \times 4 = 9\,600$ dollars. (b) $40\,000 + 9\,600 = 49\,600$ dollars. (c) $49\,600 \div 48 = 1\,033.33$ dollars a month.
3. (a) $11\,400 \div 15\,000 \times 100 = 76\%$. (b) The target was not reached, so the money goes back to the backers and the designer receives nothing. It suggests the public is less keen on the idea than hoped, so the design or price may need rethinking before trying again or turning to another source.
4. A van is a non-current asset used for years, but an overdraft is short-term finance: its interest rate is often high and the bank can ask for the money back at short notice, leaving the business short of cash for wages and fuel. A long-term source such as a bank loan, hire purchase or leasing spreads the cost over the van's life.
5. Only limited companies can issue shares, and a sole trader is not a company. She could use a bank loan (with collateral if the bank asks for it), her own savings or retained profit, a grant if one is available, or crowdfunding; any two.

Past questions to try

- 0450/23/M/J/24 Q2: part (b), choosing between owner's savings, microfinance and crowdfunding for a start-up.
- 0450/21/M/J/25 Q3: part (a), two advantages and two disadvantages of a bank loan.
- 0450/13/O/N/24 Q2: part (e), whether crowdfunding is the best source for a start-up.
- 0450/21/M/J/24 Q4: part (a), two factors a private limited company considers when choosing a source.