

1.3.5 Sources of Finance

Activity 1:

Using the following sources of finance, identify which are short term, medium term and long term sources of finance.

Owner's capital/savings	Overdraft	Trade credit	Ordinary share capital	Hire purchase
Venture capital	Leasing	Bank loans	Mortgage	Sale of assets
Retained profits	Debenture			

Short Term Sources (1-2 years)	Medium Term Sources (3-10 years)	Long Term Sources (Over 10 years)

1.3.5 Sources of Finance

Activity 2:

Complete the following table by identifying the advantages and disadvantages for the different sources of finance:

Source of Finance	Description	Advantages	Disadvantages
Owners Savings	When the owner uses his or her own savings to invest in the business. Usually a sole trader will start up a business with their own savings.		
Sale of Assets	When a business sells off fixed and current assets which it no longer needs in order to raise finance for new projects.		
Retained Profit	Profit kept after all expenses and dividends are paid out. The profit left can be 'ploughed back' into the business for expansion purposes. It belongs to the business		

1.3.5 Sources of Finance

Overdraft	The bank allows a business to go 'overdrawn' up to an agreed amount. The business only pays interest on the amount overdrawn. The amount of interest paid is usually higher than a bank loan so caution is needed when using an overdraft. Usually used to pay small bills and expenses.		
Trade Credit	When suppliers give time to pay for supplies and stock – usually with a 30 day payment period. This can be difficult for sole traders to acquire in the early days.		
Leasing	When an asset is used by a business but is never owned by the business. The business pays a monthly amount to use the asset and in return they have access to the latest equipment and support if the asset breaks or needs repair. Many businesses lease cars or computer equipment.		

1.3.5 Sources of Finance

Hire Purchase	When an asset is bought over a period of time with repayments made each month until the final payment when the item becomes the property of the firm. This spreads the cost of purchasing assets.		
Bank Loan	An amount of money is borrowed from the bank and then repaid with interest over a set period of time. The loan period can range from 1 year to 10 year. Look for the APR amount – the higher the APR the more interest is paid.		
Debentures	Long term borrowing similar to selling shares, but with the promise of repaying the amount borrowed at a fixed period in time, usually for a set amount of interest. Usually used by large organisations and the debenture is fixed upon a particular asset.		

1.3.5 Sources of Finance

Mortgage	This is a long term loan (usually over 25 years) provided by a bank/building society in order to buy property. Usually secured on the property itself so if repayments are not made the mortgage lender can repossess the property.		
Venture Capital	Venture capitalists (Dragons Den, Peter Jones) invest in small, risky business e.g. new business start-ups or existing businesses which need investment such as Levi Roots		
Ordinary Share Capital	A share in the business is sold to an individual or another business. This money is then used to purchase new assets or to expand. The business changes from a Ltd to a plc and shares can be traded on the stock market.		

1.3.5 Sources of Finance

Activity 3: Read the following scenarios and complete the table on the most suitable source(s) of finance for each scenario. For many, there is more than one source of finance available so be prepared to justify your answer.

SCENARIOS:

Scenario 1: New Property

Mark Jennings is a plumber who has been working from home for the last 2 years. He would like to buy a property with plenty storage and office space.

Scenario 2: New Computer Network

Hinton Ltd specialises in producing designer t-shirts and has decided to up grade the current computer network within her offices in Manchester. She estimates that the cost of a new computer network will be £30 000 and would like to upgrade this system every 3 years.

Scenario 3: Starting up a new Fruit and Vegetable shop

Mike Randall has just been made redundant from a major high retailer. He has received a redundancy payment of £50 000 and would like to set up an organic fruit and vegetable shop in Didsbury.

Scenario 4: Expand Factory

Deslandes Ltd, who specialises in producing bird boxes would like to upgrade her current machinery in order to be more productive. She has used all available retained profits and would like to spread the cost of £100 000 over a longer period of time.

Scenario 5: Car Valeting Service

Ken Gilkes wants to set up a mobile car valeting service and needs to buy equipment such as a power jet, cleaning materials and a small white van with which to visit clients. Ken estimates that he will need at least £15 000 to buy all the necessary equipment.

1.3.5 Sources of Finance

Scenario 6: Expansion into Europe

Kotecha Ltd is a family run business selling authentic Indian food. The company has been very successful in the UK and is looking to expand its operations in Europe. They are planning to open a new factory as well as 100 outlets across Europe. This is estimated to cost £5 million.

Scenario 7: Buying a fleet of cars

Jonathan Whelan is a partner in a solicitors firm and would like to purchase 10 company cars for use by the 10 partners. They will be covering a wide geographical area and therefore each car will be subject to high mileage.

Scenario 8: Innovative Idea in need of large investment

Swiftly Ltd has just designed an innovative teabag with milk and has been turned down by the local bank and is in need of a substantial investment. She also needs support and help in launching this risky but innovative product.

Scenario 9: Buying stock

Charlotte King runs a high class boutique and needs to replenish her stock levels. She is currently experiencing cash flow problems due to the seasonal nature of her business and needs to think of ways of getting new stock.

Scenario 10: Paying telephone bill

Sophie Leader runs a small hairdressing salon in Prestwich and has had a final demand from her telephone provider. She is currently having cash flow problems and needs to pay the bill before she is cut off!

1.3.5 Sources of Finance

Look at the 10 scenarios and complete the table below. For each scenario you must identify:

- Whether the business has Unlimited or Limited Liability
- The most appropriate source(s) of finance
- Whether the chosen source(s) of finance are internal or external sources of finance
- Explain why you have chosen these sources of finance – try to match the appropriate form of finance against the organisation type.

Scenario	Unlimited/Limited Liability	Source(s) of Finance	Internal or External Source	Justification
1				
2				
3				

1.3.5 Sources of Finance

Scenario	Unlimited/Limited Liability	Source(s) of Finance	Internal or External Source	Justification
4				
5				
6				
7				

1.3.5 Sources of Finance

Scenario	Unlimited/Limited Liability	Source(s) of Finance	Internal or External Source	Justification
8				
9				
10				

1.3.5 Sources of Finance

Teacher Guidance

Activity 1

This activity is to be completed after students have an idea of all the different sources of finance available to different sized organisations. They must understand each of the sources of finance in order to consider the time period. Students can then complete the table as to which are short term, medium term or long term sources of finance.

This is to get them to think about the appropriateness of the different types of finance available. You could extend this activity by getting them to complete a simple chart which shows which types of organisation have access to the different sources of finance. This is to show that the larger the organisation, the more sources of finance are available.

Source of Finance	Sole Trader	Partnership	Private Limited Company	Public Limited Company
Owners savings	✓	✓	✓	✓
Retained Profits	✓	✓	✓	✓
Sale of assets	✓	✓	✓	✓
Overdraft	✓	✓	✓	✓
Bank Loan	✓	✓	✓	✓
Trade Credit	✓	✓	✓	✓
Leasing	✓	✓	✓	✓
Hire Purchase	✓	✓	✓	✓
Venture Capital	✓	✓	✓	✓
Share Capital			✓	✓
Debentures			✓	✓

1.3.5 Sources of Finance

Activity 2

This activity can be set as a homework or split the students into groups to see if they can identify the advantages and disadvantages of each source of finance. They should consider the ease of obtaining each source of finance as well as the overall cost of each method.

Activity 3

This activity is to get the students to consider the appropriateness of each source of finance and asks them to justify their answers. For many of the scenarios, there is more than one source of finance which could be used. A useful discussion could be had when students have completed the table and are then asked to compare their answers.

This activity is also useful for the Supported Multiple Choice questions and could be rearranged into this type of format with 4 options being given for students to choose from.

E.g. Scenario 10: Paying telephone bill

(a) Sophie Leader runs a small hairdressing salon in Prestwich and has had a final demand from her telephone provider. She is currently having cash flow problems and needs to pay the bill before she is cut off.

The **most likely** suitable source of finance would be:

- A Bank Loan
 - B Overdraft
 - C Leasing
 - D Sale of assets
- (1 mark)

Answer:

(b) Explain your answer: (3 marks)