

Four original cases in the shape the paper uses: a short extract, then questions rising from definition through analysis to evaluation. The figures are illustrative rather than official – chosen so the business reasoning works, which is what the exam tests. The commentary names where each mark sits.

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Case 1 – A family firm considers external finance

EXTRACT. Meridian Furniture is a private limited company owned by the founding family. Revenue last year was \$18m with an operating profit of \$1.4m. It wants \$6m to open a second factory. Its bank offers a five-year loan at 9%; a private-equity investor offers \$6m for a 30% equity stake and one board seat. Gearing is currently 20%. The family says it ‘will not lose control of the business’.

I Define gearing. [2]

Gearing is the proportion of a business’s long-term capital that is financed by debt rather than equity, usually calculated as long-term liabilities divided by capital employed and expressed as a percentage.

Commentary: One mark for the idea of debt as a share of capital, one for how it is measured. A definition that only says ‘how much a firm borrows’ earns the first mark only.

I Analyse two factors Meridian should consider when choosing between the loan and the equity investment. [8]

First, the effect on control. Equity finance gives the investor 30% of the company and a board seat, which means the family can be outvoted on strategic decisions and must justify its plans to an outsider; a loan leaves ownership untouched, so the family’s stated objective of retaining control points to the loan. Second, the effect on risk and cash flow. A \$6m loan at 9% adds about \$540,000 of annual interest against an operating profit of \$1.4m, raising gearing from 20% towards a level where a downturn could leave the firm unable to service the debt; equity carries no fixed repayment, so it protects liquidity if the second factory takes time to reach capacity.

Commentary: TWO factors, each ANALYSED – the analysis mark is the consequence chain, not the naming. ‘Control’ alone is a point; ‘which means the family can be outvoted on strategic decisions’ is the analysis.

Commentary: Use the numbers from the extract. \$540,000 against \$1.4m is doing the work that ‘interest is expensive’ cannot.

I Evaluate whether Meridian should accept the private-equity investment. [12]

The case against is the one the family makes: a 30% stake with board representation compromises the independence that a family firm is usually run to protect, and private-equity investors typically seek an exit within five to seven years, which imposes a timetable the family has not chosen. The case for is financial resilience – the loan’s fixed \$540,000 charge must be paid whether or not the new factory performs, and with gearing rising above 40% a single bad year could threaten solvency, whereas equity absorbs that risk. The decision therefore turns on how confident Meridian is in the second factory’s cash flows and on how quickly it reaches capacity: if demand is proven and the payback period is short, the loan preserves control at acceptable risk and is preferable; if demand is uncertain, the equity stake buys insurance that is worth the loss of some control. On the evidence given – an established firm with a 7.8% operating margin expanding an existing product line rather than entering a new market – the risk is moderate and the loan is the better choice, provided the family accepts covenants limiting further borrowing.

Commentary: An evaluation mark needs a JUDGEMENT plus the criterion it rests on. ‘It depends’ with no criterion earns nothing; ‘it turns on how confident Meridian is in the cash flows’ names the criterion.

Commentary: The judgement is justified from the extract’s own evidence – established firm, existing product line – not from a general preference for debt or equity.

Commentary: The qualification at the end (‘provided the family accepts covenants’) shows the answer is aware of its own conditions, which is what separates the top band.

Case 2 – A retailer responds to falling footfall

EXTRACT. Calder Stores runs 40 high-street shops. Footfall has fallen 12% in two years while its online sales have grown 40% to 25% of revenue. Its stores carry a fixed cost base of \$22m a year. Management proposes closing 10 of the worst-performing stores, investing \$5m in the website, and retraining 150 staff for fulfilment roles.

I Explain one benefit and one drawback of Calder’s proposal for its stakeholders. [6]

A benefit for shareholders is that closing 10 loss-making stores removes a share of the \$22m fixed cost base, which raises operating margin at the current level of revenue and funds the website investment from savings rather than new borrowing. A drawback for employees is that retraining 150 staff for fulfilment roles changes both the work and, usually, its location; those who cannot relocate face redundancy, which lowers morale among the staff who remain and can raise labour turnover in the stores that stay open.

Commentary: Name the STAKEHOLDER for each. An answer that discusses benefits and drawbacks in the abstract loses the application marks.

Commentary: Each point runs to a consequence – ‘raises operating margin’, ‘can raise labour turnover’ – rather than stopping at the change itself.