

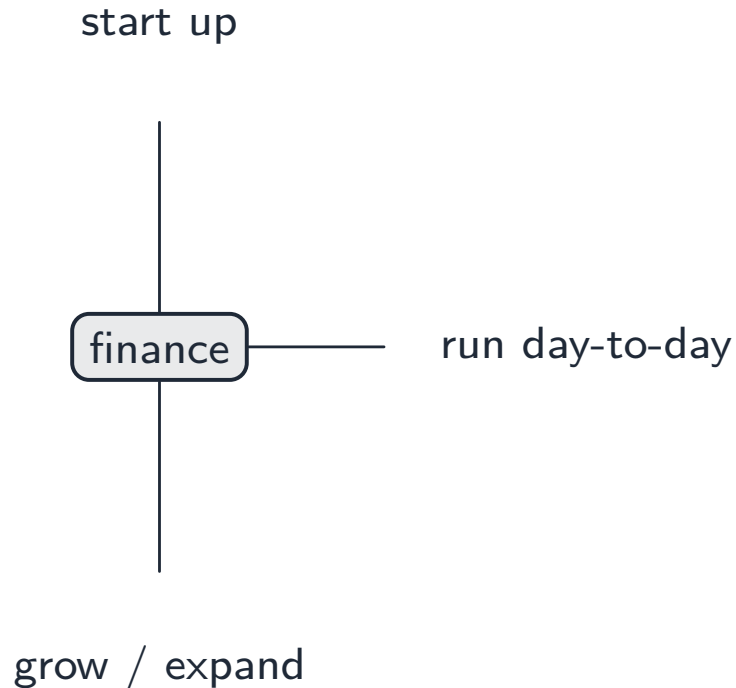
Exercise walk-through

5.1

Business finance: needs and sources

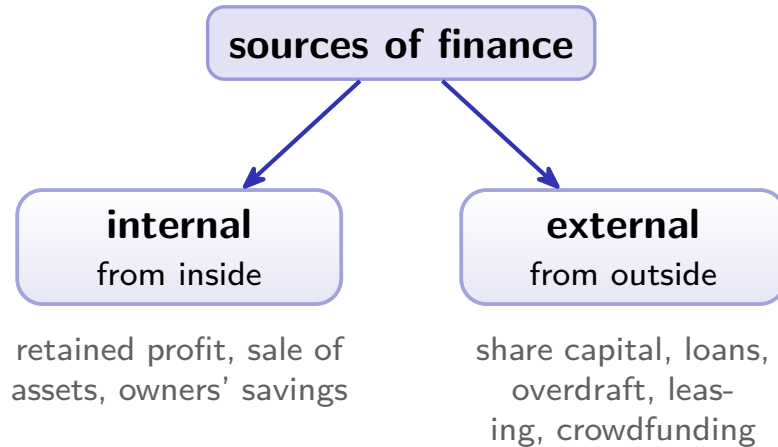
IGCSE Business Studies

Why finance is needed



- start up – **start-up capital** to buy equipment and stock before it earns anything,
- grow – money for **expansion**, such as new shops or machines,
- run day to day – **working capital** to pay wages and suppliers while waiting for customers to pay,
- survive a **cash-flow** problem, when more money is

Sources of finance



Banks are a key external source of business finance, through loans and overdrafts.

The external sources of finance

hire purchase

buy now and pay in **monthly parts**; the asset is owned only at the end

microfinance

small loans for **tiny businesses in poorer areas**, where banks will not lend

crowdfunding

many people each give a small amount, usually online

debentures

long-term loans paying fixed interest, repaid on a set date

grants

money from government that does **not have to be repaid**, usually with conditions

share issue

raises large sums and **dilutes ownership** – available only to a company

To overcome a cash-flow problem a business can arrange an **overdraft**, **delay paying suppliers**, or **ask customers to pay sooner** – all short-term, and all with a cost.

Choosing a source

The best source depends on how much money is needed and for how long, the cost (interest and fees), the size and legal type of the business (only companies can sell shares).

Cash flow

- start up – **start-up capital** to buy equipment and stock before it earns anything,
- grow – money for **expansion** , such as new shops or machines,
- run day to day – **working capital** to pay wages and suppliers while waiting for customers to pay,
- survive a **cash-flow** problem, when more money is going out than is coming in.

Exercises 2.1-2.3

2.1 State two reasons why a business needs finance. [2]

2.2 Identify two **internal** sources of finance. [2]

2.3 State the difference between a bank *loan* and an *overdraft*. [2]

Exercises 2.1-2.3

2.1 State two reasons why a business needs finance. [2]

2.1

- any **two** of: start up / expand / working capital / survive a cash-flow problem (K, K)
-

2.2 Identify two **internal** sources of finance. [2]

2.2

- any **two** of: retained profit / sale of assets / owners' savings (K, K)
-

2.3 State the difference between a bank *loan* and an *overdraft*. [2]

2.3

- a **loan**: a fixed sum repaid with interest over time (K)
- an **overdraft**: the account can go below zero for short-term needs (K)

Exercises 3.1-3.2

3.1 Identify two external sources of finance.

[2]

3.2 Explain two factors a business should consider when choosing a source of finance. [6]

Exercises 3.1-3.2

3.1 Identify two external sources of finance. [2]

3.1

- any **two** of: bank loan / overdraft / new shares / leasing / hire purchase / trade credit / crowdfunding / grants (K, K)

3.2 Explain two factors a business should consider when choosing a source of finance. [6]

3.2

- for **each** of two factors: K + An, max 3 each
- e.g. **amount and time**: a large, long-term need → a long-term loan, not an overdraft
- e.g. **cost**: high interest raises costs → a cheaper source is better if available

Exercise 3.3

3.3 A sole trader needs a large amount of money to buy a new machine. Do you think a bank loan is the best source of finance for this? Justify your answer. [6]

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3.3 A sole trader needs a large amount of money to buy a new machine. Do you think a bank loan is the best source of finance for this? Justify your answer. [6]

3.3

- **for a loan:** large sum, repaid over the machine's life, owner keeps control
- **against:** interest, repayments even in a bad year, unlimited liability
- **judgement (Ev):** a loan suits a large long-term purchase if repayments are affordable; leasing if cash is tight