Exercise walk-through

Sources of finance ▪ 5.2

eXercise

You must be able to

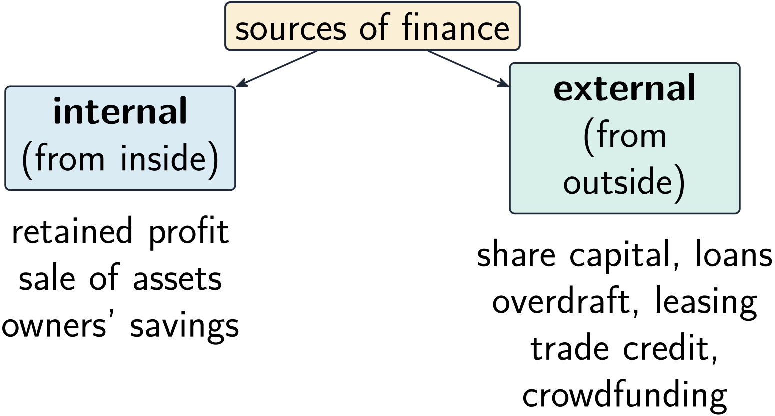
- classify sources as internal/external and short/long-term
- describe the main sources (retained profit, share capital, loans, overdraft, trade credit, leasing)
- analyse and evaluate the best source for a given need

Method — Where finance comes from

- **Internal:** retained profit, sale of assets — no interest, no loss of control, but limited.
- **External:** share capital and loans (long-term), overdraft and trade credit (short-term).
- **Choice depends on:** the **amount**, the **purpose** (match long-term assets to long-term finance), the **cost** (interest), the legal structure (only a company sells shares), and **collateral**.

Answer shapes: AO1 + AO2 + AO3 (reasoning chain) + AO4 (a supported judgement *in context*).

Method — Where finance comes from



Sources of finance come from inside (internal) or outside (external) the business

Practice 2.1 ▪ 2 marks

Define the term *retained profit*.

Solution 2.1

Method: Where finance comes from

Worked steps

profit kept in the business (not paid out to owners) and used to finance the firm (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 2 marks

State two **external** sources of finance.

Solution 2.2

Method: Where finance comes from

Worked steps

any two of: share capital; bank loan; debenture; overdraft; leasing; hire purchase; trade credit; venture capital; crowdfunding $(1 + 1)$.

Practice 2.3 ▪ 2 marks

State the difference between a *loan* and an *overdraft*.

Solution 2.3

Worked steps

a loan is a fixed sum borrowed and repaid with interest over a set time; an overdraft lets the bank account go below zero for a short time, for smaller, short-term needs (2 for a clear difference; 1 for a partial idea).

Exam-style 3.1 ▪ 3 marks

Explain one benefit to a business of using **retained profit** to finance growth.

Solution 3.1

Method: Where finance comes from

Worked steps

[3] **AO1** 1 — name a benefit (no interest; no loss of control; no repayment date). **AO2** up to 2 — develop it, e.g. retained profit costs no interest $\rightarrow$ cheaper than a loan $\rightarrow$ more of the return stays in the business (2 developed / 1 limited).

Exam-style 3.2 ▪ 8 marks

Analyse two factors a business should consider when choosing a source of finance.

Solution 3.2

Method: Where finance comes from

Worked steps

[8] For **each** of two factors: **AO1** 1 + **AO2** 1 + **AO3** up to 2. Example chains — *purpose/term*: a long-term asset → financed by long-term finance → repayments matched to the income the asset earns. *Cost*: a high-interest source → raises costs → lowers profit, so a cheaper source is better if available. Maximum 4 per factor, 8 total.

Exam-style 3.3 ▪ 12 marks

A growing private limited company needs $2 million to build a new factory. Evaluate whether it should raise this money by a **bank loan** or by **selling more shares**.

Solution 3.3

Method: Where finance comes from

Worked steps

[12] **AO1** 2 / **AO2** 2 / **AO3** 2 / **AO4** up to 6. **Loan:** keeps ownership and control, interest is tax-deductible — but it must be repaid with interest and needs collateral, raising risk. **Shares:** no repayment and no interest — but ownership and control are diluted, dividends are expected, and an Ltd can only sell shares privately. Judgement: a stable firm confident of repaying may prefer a loan to keep control; one wanting to avoid fixed repayments may prefer shares — it depends on its existing debt, profits and the owners' wish to keep control.