



Section 3.1

Activity 3.1.1

Internal sources of funds may be unavailable or inadequate for the following reasons:

- a. Losses lead to negative cash flow and the value of assets to sell has fallen
- b. Cash outflows are rising faster than inflows
- c. Time delay between the cash inflow from the festival and the cash outflow of buying stock.

Activity 3.1.2

1. Internal finance is raised from the business's own assets or from profits left in the business (retained profit).
External finance is raised from sources outside the business (bank loans).
2. Sources of internal finance that might be available to the company in the case study might be:
 - Retained profits
 - Sale of assets
 - More efficient management of working capital.
3. The advantages of the case study business raising funds through loan capital might be:
 - Bank loans and debentures are a source of accessible large-scale finance for research and development projects
 - The business keeps control over decision-making because it still retains ownership
 - Interest and repayment can be budgeted over a set time period that the business can manage.

The disadvantages might be:

- The cost of interest payments
- Repayment of the loan
- Interest rate changes can change the cost of borrowing
- Lenders can impose conditions on loans.

Activity 3.1.3

1. A benefit of subsidies to Indian leather businesses and EU farmers might be:
 - It reduces costs and increases profits
 - It can be used to finance new capital investment.



2. It might be unwise for these businesses to depend on subsidies because governments can cut or withdraw them and it is difficult to sustain the business model in the long run.

Activity 3.1.4

1. A 'rights issue' is where existing shareholders are given the right to buy additional shares at a discounted price.
2. Tata might have used a rights issue rather than long-term loans to raise finance because:
 - Share capital does not have to be repaid
 - Dividend does not have to be paid each year but interest does.
3. The impact of Tata's decision to raise new finance through a share issue on different stakeholders might be:
 - Shareholders – reduces their control and dividend per share
 - Managers – new shareholders might change the influence on decision-making
 - Employees – new shareholders change the direction of an organisation
 - Local community – profit is put ahead of social responsibility
 - Suppliers – drive to increase profits means the business puts pressure on suppliers to reduce prices.

Activity 3.1.5

1.
 - a. 'Convertible debentures' are loans that can be switched into shares after a certain period of time.
 - b. 'Working capital' is the funds a business has to meet its day-to-day operations (current assets - current liabilities).
2. Raising funds by selling debentures has the following advantages:
 - Provides a source of accessible long-term finance
 - The business retains control over decision-making because it still retains ownership
 - Interest and repayment can be budgeted over a set time period that the business can manage.

The disadvantages might be:

- The cost of interest payments
- The repayment of debentures
- Administration of the debenture issue.

Exam practice question

1.
 - a. A 'public limited company' (plc) is an organisation that sells shares in its business to the general public through a stock exchange.



- b. A 'share price' is the price of a business's shares that are traded on the stock exchange.
2. a. $\$3.42 \times 1.15 = \3.93
b. The share price of StarJet might increase in the future if:
- StarJet is profitable
 - The low-cost air travel market grows
 - There is a potential takeover of StarJet.
3. Stavros may be reluctant to raise additional capital by selling shares because:
- He could lose control of the business
 - The dividend per share of existing shares could fall.
4. The sources of funds StarJet could use to fund a future takeover includes:
- Bank loan – keep control but repayment and interest costs
 - Debentures – keep control but repayment and interest costs
 - Share issue – No payment or interest but more loss of control.

Key concept question

Ethics might have had the following influences on raising finance:

- Whether a source of finance is an ethical lender
- The loan agreement and the fairness of the terms of repayment and interest
- The ethics of the activity the finance is being raised for
- Decisions about defaulting on repayments.

Culture might have had the following influences on raising finance:

- The source of finance favoured
- Loan agreements in terms of interest and repayment
- Nature of the activity the finance is being raised for
- The potential reaction to breaking a loan agreement.