

Chapter 18: Exam practice question

easyJet takes off to 342p share price

- 1 Define the terms:
- a public limited company (2)
- This is a limited liability, incorporated entity whose shares are publicly traded on the stock exchange.
- b share price. (2)
- This is the amount at which shares are bought and sold on the stock exchange. There is usually a bid rate at which shares are bought. This is slightly above the offer rate at which shares are sold. The difference is called the spread.

Apply **Resources table 3a** mark band descriptors.

- 2 Outline two possible sources of long-term finance available to easyJet. (6)
- These could include:
- bank term loan
 - share issues
 - long-term bond
 - leasing of planes or long-term equipment – may include sale and leaseback of assets

Each source should be stated, explained and linked to the case study for maximum marks.

Apply **Resources table 3b** mark band descriptors.

- 3 Explain why an expansion in easyJet's passenger numbers has increased the need for short- and long-term finance. (6)
- Short-term finance:
- More working capital is needed to run the business day to day.
- Long-term finance:
- More fixed assets may be needed to support the increased size of operations. This should be financed by long-term financial means in order to match the term of the need.

SL: apply **Resources table 1** mark band descriptors.

HL: apply **Resources table 2** mark band descriptors.

- 4 Evaluate the view that easyJet's decision to raise long-term finance by selling shares is preferable to raising it through borrowing. (9)

Shares preferable:

- Dividends need not be paid if profits are low or if money is needed in the business.
- Size of dividends is flexible, whereas interest on term loans is out of the control of the business.
- Shares are not limited by leverage and so finance can be raised this way even when banks refuse to lend more.
- It never needs to be repaid.

Borrowing preferable:

- Issuing shares can dilute ownership whereas borrowing does not.
- Issuing shares can result in loss of control of the company whereas borrowing does not.
- Dividends are paid after tax whereas loan interest is pre tax.
- Gearing increases and so this gives the chance of higher returns for shareholders.
- Issuing more shares can result in a fall in the share price.

SL: apply **Resources table 1** mark band descriptors.

(SL questions do not usually go up to 9 points, so the HL table is best used for SL students.)

HL: apply **Resources table 2** mark band descriptors.

A justified conclusion is required.