Bentley Wood
High School for Girls

Business
GCSE to A level

Bridging Work
Year 11 into 12 for 2021/22

Name: _____

Tutor Group: _____

Teacher: _____

Name: **A Level Business 2021 Bridging Work**

A Level Business Bridging Work

Tasks to be completed for A Level Business Bridging work:

Task 1-**Read the resource on Note-taking (Appendix 1)** to understand the different methods of Taking notes and Making notes.

Do not complete Tasks 2 and 3, without completing Task 1 first!

Task 2-Using one of the **note-taking methods from the resources provided in Appendix 1,** make notes on **Business Ownership**, using the **website link** below and the textbook chapters from **Appendices 2.1 and 2.2**.

https://www.tutor2u.net/business/reference/business-organisation-introduction-to-business-ownership

Task 3-Using one of the **note-taking methods from the resources provided in Appendix 1,** make notes on **Sources of Finance**, using the **website link** on the **Task 3 sheet** and **Appendix 3.**

https://www.tutor2u.net/business/reference/sources-of-finance-for-a-startup-or-small-business

Task 4-**Choose one of the following tasks:**

a) **Netflix**-Watch the documentary **'American Factory'** and consider arguments **'For'** and **'Against'** big US businesses in moving their production to China. Using the weight of both arguments, **evaluate** whether US businesses can justify moving their production to China.

OR

b) **Spotify and BBC Sounds**-Listen to **5 business-related podcasts** from **'50 Things That Made the Modern Economy'** - Tim Harford and summarise each podcast.

Name: **A Level Business 2021 Bridging Work**

All tasks are to be completed by **21st September 2021.**

Appendix 1

Bridging Work Resource Sheet for A-level Business and Economics.

An Introduction to the Skill of Note-taking: Taking Notes and Making Notes

During your A-level studies, and indeed your degree, you will be expected to make sense of the many hours of teaching/lecturing you receive, and any further reading/research that you have completed. The best and most efficient way of coping with so much information is to **take notes** at the time, from which further (and better) **notes can be made** when they are needed (such as for **revision**).

There are many methods of taking notes and you must choose the style that best suits you. In the lesson/lecture there are many styles of note-taking available to students and these will largely be determined by the format of the presentations you receive. Many A-level teachers provide handout material to assist your note-taking **('guided notes method')**: such resources encourage active learning by providing a framework of headings for you to understand the main elements of the topic, whilst requiring you to fill in some of the details and examples as they are being explained.

In the absence of supporting materials, you need to develop a style that will best enable you to filter the most important points, explanations and examples from the session, whether that be in a **linear written form** (using shorthand, where necessary: see the following guide developed by the University of Portsmouth (http://tinyurl.com/psu4cyt) or through a **non-linear method**, perhaps including visual cues, such as mapping ideas as they develop. Whatever

you choose, the method needs to capture the essential points of the lesson/lecture and filter out the digressions, anecdotes and asides that are not directly relevant to learning the topic.

Cornell method of note-taking

This refers to a method popularised by Professor Walter Pauk at this American Ivy League university in the 1950s, which may be used for lessons/lectures but strikes me as especially useful for making sense of further reading and research, and building on earlier notes, to achieve a greater degree of understanding and synthesis of a topic. It involves dividing the page into two columns, with the one on the right much larger than the one on the left. The left is used for key words/terms/ headings; the right is used for explanations and examples, in shorthand written form. The last few lines of the page are meant to be left blank for questions or for a short summary of the session – but I would reserve this for the end of your topic notes rather than for every page.

Notes should be frequently reviewed, added to and re-made in the important transformation process that has to take place during the revision process.

Note-taking: the top five

- Remain active in lessons/lectures by taking detailed notes
- Adopt a style that best suits you – linear notes or non-linear mapping?
- Use shorthand where possible to increase the efficiency of your note-taking – and ensure that you capture everything you need
- Review, add to and re-make your notes
- Transform your notes for revision

Introductory Tasks common to all subjects

1. Find the **note-taking resources** on the P Drive (Student Drive), titled P:\Bridging work for Business, Economics, Law and Gov Pol

and work through the activities to get a feel for note-taking methods.

2. Visit the University of Bradford's note-taking page to find resources and specific guidance on the Cornell method: http://www.bradford.ac.uk/academic-skills/writing/study/effective-learning/note/
3. Now **complete the Bridging Work for your chosen A-level subject(s).**

Chapter 2

Understanding different business forms

Introduction

This chapter builds on Chapter 1: Understanding the nature and purpose of business. It considers the forms that may be adopted by the UK's diverse businesses and the issues that relate to these. It will explore the implications of different forms of ownership for important aspects of a business's operations, such as its decisions and performance. It will examine the role of shareholders as owners of companies and why company share prices alter and what this means for the organisation and its stakeholders.

What you need to know by the end of this chapter:

- why businesses choose to operate in a particular form or to change the form that they use
- the issues that businesses face arising from decisions about which business forms to use
- the role played by shareholders and the reasons they decide to invest in companies
- the factors that influence share prices and the significance of changes in the prices of companies' shares
- the effects of different types of ownership on a business's mission, its objectives, decisions and ownership.

Private sector businesses

If a business operates in the private sector of the economy it is owned by shareholders (in the case of companies) or by private individuals. Large businesses such as GlaxoSmithKline and small ones such as a local corner shop are part of the private sector. Private sector businesses are not owned by government, local authorities or other state organisations. Most businesses in the UK are part of the private sector and this is the case in most developed economies.

1. Sole traders

When individuals establish and operate a business on their own they are known as '**sole traders**', or sometimes as 'sole proprietors'. This is a very popular form of business. In 2013 there were 3.1 million sole trader businesses in the UK – 62.6 per cent of all businesses in the private sector.

Sole traders are normally relatively small businesses such as plumbers, decorators, window cleaners and hairdressers. The people running these sole trader businesses work for themselves. It is not uncommon for sole traders to hire other people to help them out, but they remain responsible for the overall business and are actively involved in the running of it on a daily business. In 2013 only 9 per cent of sole trader businesses hired any employees.

Sole traders may work on their own, and must have the confidence to take decisions and the range of skills necessary to run the business, including managerial skills. Sole traders may have to serve customers, decide what equipment to buy, deal with suppliers and keep accurate and up-to-date business records. This can require a wide range of skills and an enormous degree of flexibility.

Operating as a sole trader requires a high level of self-discipline because there is no one checking up or offering guidance. This can be exciting. It does, however, place a considerable emphasis on self-motivation. Sole traders have to make things happen and ensure they manage their time effectively.

The advantages of operating as a sole trader

One of the main advantages of being a sole trader is that it is so easy to start up and manage this form of business. Unlike starting other types of organisation, such as companies, it is not necessary to register the business with a government agency or fill in any forms. Sole traders can simply start trading, provided any profits are declared to HMRC (Her Majesty's Revenue and Customs), which is responsible for collecting taxes

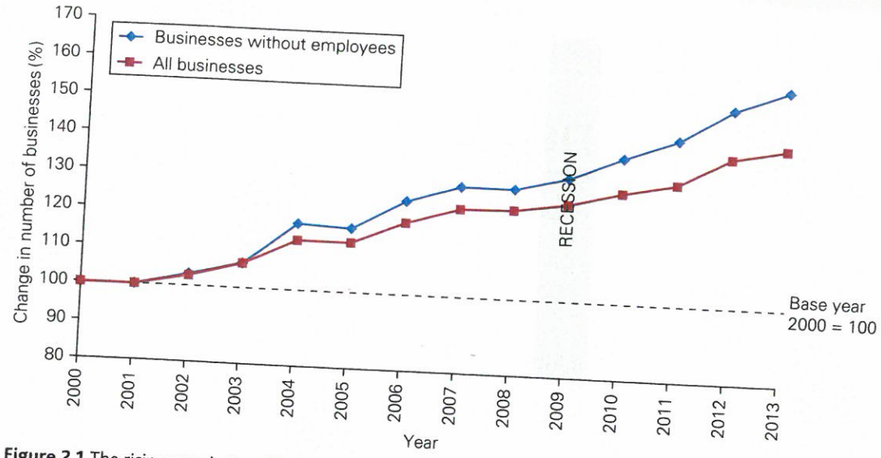

Figure 2.1 The rising popularity of businesses without employees

Source: Business population estimates, 2013 (Department for Business, Skills & Innovation)

on profits in the UK. Thus it is possible for someone to start up and operate as a web designer, an artist, an interior decorator or cleaner at short notice and with little administration required.

Many sole traders also enjoy not having to take orders from others. They like the freedom to make their own decisions, to decide when and where to work, what to do and how to do it. Working as a sole trader allows people to make decisions quickly as they do not have to consult or request permission from their boss. It can be incredibly motivating to be your own boss.

Another important advantage of being a sole trader is that any profits made by the business do not have to be shared. Many entrepreneurs begin and continue to trade as sole traders for these reasons.

The benefits of operating as a sole trader are reflected in the increasing number of this form of business in the UK. Figure 2.1 shows the increase in the number of businesses in the UK that do not have any employees over the period 2000 to 2013, compared with all businesses.

Not all businesses without employees will be sole traders, but most will.

What do you think?

Why do you think that the number of businesses without employees grew while the UK was suffering a deep recession (when employment, incomes and spending fall) between 2008 and 2010?

The number of sole traders in the UK has been boosted by the increasing popularity of becoming self-employed, that is working for yourself. The number of people registered as self-employed in the UK has risen from 3.8 million in 2008 to 4.4 million in 2014. The prospects of high financial rewards do not appear to be driving this trend as the average income of self-employed people in the UK was £13,500 per year in 2014, not much more than 50 per cent of the average annual income in the UK.

The challenges of being a sole trader

While working as a sole trader can be very fulfilling, it also brings with it many challenges. Making all the decisions can be exciting, but there is the pressure of holding all the responsibility if anything goes wrong. When working with, or for someone else and there is a real problem, there is someone else to work with to solve it. Being a sole trader can be quite lonely – some people find it difficult to cope with this aspect of the pressure. The hours may be quite demanding, too. This is particularly likely to be an issue in the early years when an entrepreneur is trying hard to build up the business. Also, sole traders may not be able to take much time off for holidays because they may not be able to afford to close the business and risk losing customers.

Business in focus: Jane's social media

Jane Binnion is a sole trader in Lancashire. Her business provides training to local businesses and other organisations on the use of social media such as Facebook and Twitter. Jane spent 25 years employed in a range of businesses. However, an injury led to her becoming unemployed and she retrained for her new role. In her own words: 'I'm a great networker so I trained in social media, got a business adviser, a website, joined a start-up course and on March 10th 2011, aged 48 1/3, I launched Jane's Social Media!'

Jane believes that the freedom to make decisions about working life, particularly working patterns, brings benefits to sole traders and their families. One of her reasons for starting Jane's Social Media was that she needed more flexible working hours. 'I work from home and ensure that 90 per cent of the time I am here when my daughter gets home from school. I have never been happier.' Operating as a sole trader means such decisions will not be challenged.

Jane's business can respond quickly to the needs of its customers and provide an individual service, helping it to achieve high levels of customer satisfaction. Jane's Social Media promotes itself as providing: 'a personal and very individual service that helps your company grow by getting you better connected via the appropriate social media platforms.'

Source: Adapted from various sources including:
www.janebinnion.com
www.theguardian.com/small-business-network/2012/nov/28/starting-up-jane-s-social-media

Questions

1. Was being able to be her own boss the most important reason behind Jane becoming a sole trader?
2. Do you think that operating as a sole trader means that a business will always be able to make quick, effective decisions?

Sole traders often face difficulties in raising finance to set up and expand their businesses. Major sources of finance are their own money (perhaps from savings or redundancy pay) or money from friends and family. Using these sources of finance means that the amount that can be raised is often quite limited. Of course, it is possible to borrow from a bank or other financial institution but they often charge smaller businesses quite high interest rates because they are worried about the risk of failure and want to cover their losses. And since the financial crash of 2008 and the recession that followed it, banks in the UK have been much more cautious in lending money to businesses, especially those that they judge to be risky.

Being a sole trader is also quite risky if anything goes wrong. This is because sole traders have **unlimited liability**. The sole trader keeps any rewards the business makes, but is also personally responsible for any losses. If their businesses have problems, sole traders can lose their personal possessions such as houses and savings.

Key terms

A **sole trader** is a business that is owned and managed by one person, but it may employ other people.

Unlimited liability occurs when an individual or group of individuals is personally responsible for all the actions of their business. With sole traders, there is no distinction in law between the individual and the business so they could lose their personal assets if the business has financial problems.

Advantages	Disadvantages
Making key decisions can be motivating.	Sources of finance are limited.
Decisions can be made quickly and sole traders can respond rapidly to changes in the market.	Sole traders rely heavily on their own ability to make decisions.
Sole traders often have direct contact with the market.	It can entail working long hours, with limited holidays, leading to stress.
Setting up is straightforward.	The personal possessions of sole traders are vulnerable due to unlimited liability.

Table 2.1 The advantages and disadvantages of being a sole trader

2. Companies

Operating a business as a **company** can overcome many of the difficulties associated with being a sole trader. To set up a company, the owners have to complete various documents, including a Memorandum of Association and Articles of Association and register the business at Companies House. This process is known as **incorporation**.

A company is owned by **shareholders**. Each share represents a part of the company. The more shares someone owns, the more of the company that belongs to them.

A company has its own legal identity, separate from that of its owners. The company can own property, equipment and other goods in its own right and is responsible for its own debts. If the company fails, the

shareholders can lose the money that they invested in the business when they bought shares, but they cannot lose more than this. This is because a company has **limited liability**. This means that a company is responsible for the money it owes but that the personal possessions of its owners (shareholders) are safe. This is different from a sole trader, who has unlimited liability and could lose everything if the business had severe financial problems.

Having limited liability is essential for companies to be able to raise money by selling shares. Without it, investors would be far less likely to buy shares because of the risk to their personal possessions. If a shareholder invested in a business with unlimited liability it would mean giving money to others and risking everything. With limited liability, the maximum amount that could be lost is fixed.

The shareholders can potentially benefit in two ways from owning shares.

- The value of the company and hence the value of the shareholder's part ownership of the company may increase. In effect this increases the price at which the shares may be sold at a later date. However, company values and share prices can also fall. For example, following an announcement of lower than expected profits, the share price of Mothercare, one of the UK's well-known retailers fell by 31 per cent from 425 pence per share to 293 pence per share. At the time of writing it is 188 pence per share.
- Shareholders may receive a share of the company's profits, if they are sufficiently large. Profitable companies will distribute some of their profits to shareholders in proportion to the number of shares they hold. Profits paid to shareholders in this way are called **dividends**. Some types of shares, for example preference shares, receive fixed amounts of dividends, irrespective of the level of profits earned by the company.

Trading as a company means that the business must pay to have its accounts checked annually by independent accountants (called auditors). Furthermore the company accounts must be made public, so that outsiders can see the revenue and profits of the business, as well as what it owes. This means that a company's affairs are less private than for a sole trader.

Key terms

A company is a business organisation that has its own legal identity and that has limited liability.

Incorporation is the process of establishing a business as a separate legal identity that allows it to benefit from limited liability.

A shareholder is an investor in and one of the owners of a company.

Limited liability means that in the event of financial difficulties, the personal belongings of shareholders are safe.

Dividends are a share in the profits of a company that are distributed to the holders of certain types of company shares.

Every year in the UK new companies are created (or registered) and existing ones fail and are dissolved. As shown in Table 2.2 this involves a large number of companies. In 2012 the number of companies created in the UK increased by 13.7 per cent compared with 2011, while the number dissolved fell by 17.4 per cent. This suggests that companies in the UK were operating in an increasingly favourable environment.

	2011	2012	Percentage change
Companies registered	400,600	455,600	13.7
Companies dissolved	348,400	287,800	–17.4

Table 2.2 Births and deaths of companies in the UK, 2011 and 2012

Source: Companies House

Companies in the UK are divided into two legal categories: private limited and public limited companies.

(a) Private limited companies

Private limited companies have 'Ltd' after their names. They are generally smaller than public limited companies, and are relatively cheap to set up. It can cost as little as £15 to register a private limited company with the Registrar of Companies in the UK.

Private limited companies also benefit from limited liability. Normally this means that the liability of the shareholders is limited to the amount they invested in buying shares. However, for some private limited companies, limited liability takes the form of a guarantee that the owners of the company agree to pay if it fails. They cannot be required to pay more than they have guaranteed thereby limiting their liability.

As with all companies, they are owned by shareholders and the owners can place restrictions on who the shares are sold to in the future. For example, many (but not all) private limited companies are owned by families who limit the sale of shares to other members of the family – this makes sure that 'outsiders' do not become involved. Owners of shares in private limited companies cannot advertise their shares for sale – they have to sell them privately.

Business in focus: Cargill

Cargill is an American-owned multinational that describes itself as providing: 'food, agriculture, financial and industrial products and services to the world.' This statement reflects the diversity of Cargill's business interests. It is heavily involved in global agriculture. It purchases and trades agricultural commodities, such as palm oil; the company breeds livestock and produces food ingredients such as starch and glucose syrup, vegetable oils and fats for processed foods and industrial use. It is also involved in the energy, steel and transport industries. Cargill also has significant interests in financial services industry.

Cargill was founded in 1865 and by 2014 it had 145,000 employees working in 67 countries. The company's accounts for 2013 show that it achieved annual sales of $136,000 million and profits of $2,310 million. It is larger than the Ford Motor Company.

Cargill is a family-owned private company. The descendants of the founders own approximately 85 per cent of the company. Most of the company's spectacular growth has been due to reinvestment of the company's own profits. By refusing to become a public limited company, Cargill's owners have denied themselves the opportunity to sell shares to the general public through markets such as the London Stock Exchange.

Source: Adapted from Cargill's website www.cargill.co.uk/en/about-cargill-uk/cargill-overview/index.jsp

Questions

1. What are the benefits to Cargill resulting from trading as a private limited company?
2. Would it be possible for a business in any industry to become a major multinational organisation while remaining a private limited company?

Weblink

You can find out more about Cargill's global activities by exploring its website at www.cargill.com/worldwide/index.jsp

There is a range of reasons why the owners of private limited companies might decide to retain this legal status, rather than becoming a public limited company.

- **The desire to retain control over the company.** Becoming a public company is likely to be accompanied by the sale of large volumes of shares through stock exchanges. If a sufficient number are sold, it may be that the original owners only hold a minority of the company's shares and that control of the business has passed to those who own the majority of the shares. It is possible for companies to raise capital by issuing shares which do not give their owners' voting rights. However, companies and other organisations who purchase large quantities of the shares issued by public companies are likely to want to have a say in decision-making.
- **Taking decisions in the company's long-term interests.** If a private company converts to become a public company (through a process known as "going public") many of the people and organisations who buy its shares will be seeking short-term profits in the form of dividends. This may put the senior managers of the company under pressure to make decisions which might generate attractive levels of profits over the next year or two, but may not be in the company's best long-term interests. For example, pressure to improve profits may lead the senior managers of a company to use less environmentally-friendly production methods which could damage the company's reputation in the long-term.
- **Enjoying the profits generated by the company.** Going public and selling more shares means that there are more shareholders between whom dividends have to be shared. This results in a dilution of profits and potentially lower returns for the original owners of the business.

(b) Public limited companies

Public limited companies have the term 'plc' after their names and include many well-known businesses. Marks & Spencer, BSkyB and Vodafone are all examples of public companies based in the UK. Public companies tend to be much larger than private companies. One way to measure the size of a public limited company is through its **market capitalisation**. Market capitalisation is the total value of the issued shares of a public limited company. The value of a company's market capitalisation is calculated by

multiplying the company's current share price by the number of shares outstanding (that is, the number of shares issued and held by shareholders).

Key term

Market capitalisation is the total value of the issued shares of a public limited company.

The table below shows the UK's largest five companies as measured by market capitalisation in May 2014.

Maths moment $\frac{1+b}{c}=3$

Calculate the number of shares HSBC and GlaxoSmithKline had issued by 16 May 2014.

As with private companies, public companies are owned by shareholders, but restrictions cannot be placed on the sale of these shares. Shareholders in public companies can sell their shares to whoever they like. This can cause problems if another firm starts to buy up shares in the business in an attempt to gain control of it. Some of the shareholders may want to resist this **takeover**, but they cannot stop fellow shareholders from selling their shares.

Another difference between private and public limited companies is that shares in public companies can be advertised in the media. This is why the share prices of public companies are listed in the newspapers, but not those of private companies. Most companies become public because they want to advertise their shares to the general public and raise relatively large sums of money.

If the owners of a private company do not need to raise large sums via the sale of shares and want to maintain control over their company then they probably would not want to make it a public company.

There are benefits to businesses from trading as a public limited company.

- **Access to capital**. Public limited companies are able to sell shares freely using stock exchanges, which are efficient markets for buying and selling shares. This enables them to raise large sums of capital to fund a range of activities without having to take out expensive loans. Raising capital through share issues means that public companies are not committed to fixed interest payments as is the case when taking out a loan. The amount public companies pay shareholders in the form of dividends will reflect the profitability of the business and will not be more than it can afford.
- **Publicity**. Public limited companies are often in the media because of their size and importance. This has the possibility of generating a lot of free, or at least low-cost publicity, which can enhance the company's public image. BT, the UK's largest telecommunications company, received much positive publicity for its plans to improve its standards of customer service and speed of repairs to broadband services by creating an additional 1,600 jobs in 2014. This story was newsworthy because of the company's importance within the UK.
- **The ability to take over other companies**. Public limited companies are more able to buy other companies as they have access to capital through selling shares. They can also purchase other companies by offering the target company's shareholders their own shares in part or full payment. This can make it easier for public companies to grow relatively quickly.

Business in focus: Market capitalisation and the UK's largest companies

Rank	Company name	Sector	Share price* (pence)	Market capitalisation (£ million)	Number of employees
1	Royal Dutch Shell	Oil & gas	2,572.0	154,153	90,000
2	HSBC	Banking	632.5	119,097	267,000
3	BP	Oil & gas	507.1	96,648	97,700
4	GlaxoSmithKline	Pharmaceuticals	1,643.5	79,806	97,389
5	British American Tobacco	Tobacco products	3,513.0	66,288	87,813

*As at close of trading on 16 May 2014

Table 2.3 The UK's largest five public companies by market capitalisation, May 2014

Source: Adapted from the Stockchallenge website www.stockchallenge.co.uk/ftse.php

Questions

1. Why would a company's market capitalisation change regularly?
2. Is market capitalisation of any value in measuring the size of a public company?

Key terms

A **takeover** occurs when one company acquires control of another by buying more than 50 per cent of its share capital.

Privatisation is the process under which the state sells businesses that it has previously owned and managed to private individuals and businesses.

Reasons for changing business forms

Growth is a key factor encouraging businesses to change their forms. As a sole trader business becomes larger, the owner may decide that it requires more access to capital and that the protection of limited liability is vital and the business's potential to incur debts increases. This may result in a business becoming a private limited company. The desire to access more capital and attain a higher profile may result in companies opting to 'go public' and convert from private limited to public limited status. SAGA, a company that supplies holiday, financial and other services to people aged 50 and over, announced in April 2014 that it was to convert to public limited company status to assist it in its aim of continued growth.

The UK has seen numerous businesses transfer from the public sector to the private sector in a process known as **privatisation.** The popularity of privatisation in the UK and elsewhere can be explained by its ability to raise large sums of capital for governments and by the belief among many decision-makers that businesses tend to be more efficient when run privately rather than by the state. In October 2013 the Royal Mail was privatised and raised £3.3 billion for the UK Government.

Public sector businesses

The public sector comprises the organisations that are owned by (and sometimes funded by) national or local government. There are three major elements of the public sector:

- **Public corporations.** These are enterprises owned by the state but offering products for sale to the public and private sector businesses. These may be managed by central government (such as Channel 4 television) or by local governments, for example Manchester Airport.
- **Public services**. This category of the public sector includes organisations that provide services to the whole nation. The National Health Service (NHS) is an example.
- **Municipal services**. These are services offered by local governments and councils. Examples include libraries and leisure centres.

The size of the public sector in the UK has declined due to a series of privatisations in the 1980s and 1990s. This resulted in the sale of a large number of government-owned industries to the private sector. British Rail, the water and electricity supply industries were privatised along with British Telecommunications (BT). The aim was to increase the efficiency of these industries and to reduce the need for government subsidies. This resulted in many job losses, for example in the coal industry, as the new owners sought to create competitive businesses.

Figure 2.2 shows the declining importance of the public sector to the UK economy. Employment in the public sector has fallen steadily since 2009, while employment generally in the UK has risen with many new jobs being created by the private sector.

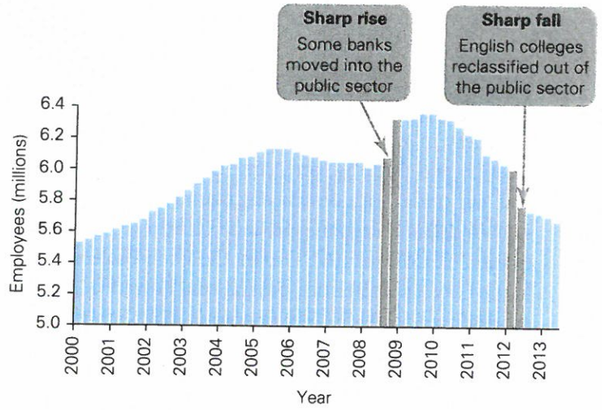

Figure 2.2 Employment in the UK's public sector

Source: Office for National Statistics www.ons.gov.uk/ons/rel/pse/public-sector-employment/q2-2013/sty-public-section-employment.html

Not-for-profit businesses

Not all enterprises are set up to make a profit. For example, local sports clubs, government organisations and charities do not have profit as their main objective. They are set up for some other purpose and can be part of the public sector or part of the private sector.

Business in focus: Wikipedia

Wikipedia was created in 2001. It is a multilingual, web-based, free-content encyclopedia project. It is written by volunteers all over the world and contains more than 4.5 million articles in English. Its articles can be edited by anyone with internet access and currently has approximately 77,000 editors.

It is now one of the largest online encyclopedias in the world, attracting 470 million visitors each month. Articles are continually updated and improved by online contributors. The website was created by the not-for-profit Wikipedia Foundation, which is a charitable organisation based in San Francisco in California. The Wikipedia foundation was set up by Jimmy Wales and employs 142 people.

Questions

1. Explain why 77,000 people work for Wikipedia without pay.
2. Is it only not-for-profit businesses that are good for society?

Weblink

To find out more, visit www.wikipedia.com

Social enterprises, for example, are businesses that have social aims and trade in order to benefit the community or society in general. Examples of social aims are job creation and training, providing community services and 'fair trade' with developing countries. Well-known social enterprises include Cafédirect, The Big Issue, The Co-operative Group, the Eden Project and Jamie Oliver's apprentice programme Fifteen. Many others (over 55,000) exist, operating in a wide range of industries from farmers' markets and recycling companies to transport providers and childcare.

Weblink

For more information on social enterprises, visit www.socialenterprise.org.uk

The owners of not-for-profit businesses operate them for a variety of reasons. They may have a strong belief in a particular issue, such as protecting the environment or caring for animals and therefore establish a charitable business to raise funds for their particular cause.

Others may be established to provide a hobby or to replace employment. Jamie Oliver has invested heavily in his restaurant chain Fifteen in part because he believes in offering a chance to unemployed young people to acquire cooking skills. His website summarises the reasons he established the chain to offer young, unemployed people the chance to gain employment skills in a restaurant.

'Fifteen represents the way I would have loved to have been taught myself; it embraces many of the things I love and feel passionate about, not only in the catering industry but also in friendship and family life.' Jamie Oliver (www.jamieoliver.com)

Study tip

When studying this chapter you need to think about the advantages and disadvantages of the different forms of business. What determines the right structure for a business? What issues are involved in choosing a business format? This involves issues such as: How much does someone need to work with others? Is outside investment required? How critical is limited liability?

Mutual businesses

Mutual businesses are relatively common in the UK, especially in certain industries such as building societies. The Co-operative Group operates a range of businesses, including retailing, agriculture, travel services, banking and funeral services.

The term 'mutual' covers several different ownership models. Mutuals are characterised by the fact that mutual businesses are run for the benefit of their members, whether they are employees, customers, suppliers or the local community. In contrast most public companies are owned and controlled by outside investors.

Mutuals can be based on a variety of different legal structures. However, there is a legal structure developed solely for mutual businesses that offers the benefit of limited liability. This is the Industrial and Provident Society (IPS). Some mutual businesses use this legal structure whereas others, including many co-operatives, are limited companies.

Co-operatives are a well-known example of mutual businesses and are run by groups of people (called members) each of whom has a say in the management of the business. Co-operatives must reflect four ethical values: honesty, openness, social responsibility and caring for others. They should also operate according to the following principles: voluntary and open membership, democratic member control, provision of education, provision of training and information and concern for the community.

Different types of co-operatives exist:

- consumer co-operatives, in which customers are the members of the business
- worker co-operatives, owned and operated by employees
- producer co-operatives, where a group of businesses work together to benefit from factors such as increased bargaining power.

Co-operatives can be popular but have faced criticism for not employing sufficient or suitably skilled professional managers, instead relying on elected members who may be well intentioned, but not suited to their roles.

Shareholders and share prices

We saw earlier that companies sell shares to raise capital for a variety of reasons and that public companies can sell shares freely.

Who buys shares?

In the UK, financial institutions such as banks, pension funds and insurance companies own most company shares. These organisations buy shares to make a profit through the dividends they receive and by selling the shares at a higher price later on. They can then pass their profits on to their own investors.

As you can see in Figure 2.3, individuals own less than 15 per cent of shares in the UK. Foreign investors own more than 50 per cent of shares in the UK.

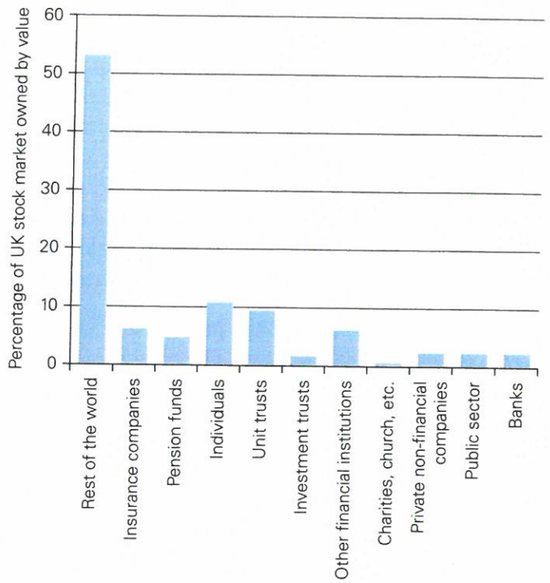

Figure 2.3 Share ownership in the UK

Source: Office for National Statistics

The reasons for and risks of buying shares

Shareholders invest in business primarily for financial reasons. They may benefit (hopefully) from an increase in the share price and from receiving a share of the profits in the form of dividends. The more profit a firm makes, the bigger the dividends are likely to be. Some shareholders invest to make a quick return and may seek out risky companies that may offer high returns. Other groups of investors, such as pension funds and insurance companies, who have large sums of other people's money to invest, may seek longer-term, more secure returns.

However, there is a substantial risk in buying shares in most circumstances. The price of shares can easily fall and this can be true of a well-managed and profitable business if the economy is not performing well. Figure 2.4 illustrates the performance of share prices for the UK's 100 largest companies (by market capitalisation) from 2008 to 2014. There was a very sharp fall in share prices during 2008 and early 2009. During this time the share prices of many well-managed, profitable companies fell sharply as their sales dipped and nervous shareholders sold their shares, depressing share prices further.

be more willing to offer loans to such companies, especially if they believe that the rising share price is the result of the business performing well. These arguments are particularly relevant if a company's share price is performing better than share prices generally.

- **Falling share prices.** This may be judged to be the result of a poor performance by the management team and may make it difficult for it to raise capital. It may also make the company vulnerable to a takeover as the cost of buying a controlling interest in the company is reduced. This is more likely to be the case if the company's share price is considered to be too low, making it undervalued. However, this might be a response to a short-term factor, such as profits being below expectations and not be an indication of the company's likely long-term performance.

Obviously the longer the trend in share prices lasts, the greater the impact. Thus a prolonged decline in share prices might affect a company's ability to recruit top-quality employees or to raise finance for major investments.

The effects of a general change in share prices

If there is a substantial fall in share prices for most companies the effects on businesses generally can be significant. Figure 2.4 shows that share prices in the UK fell very heavily in 2008 and again in 2011. This can pose difficulties for many businesses and especially those that sell non-essential products or luxury products. At a time of falling share prices, many consumers and organisations may feel that their wealth is declining and cut their spending accordingly. This reduces the sales made by a wide range of businesses, which in turn reduce their own spending, 'multiplying' the negative effect. This can provoke an economic recession, where the level of national production declines over a period of at least six months.

A period of rising share prices can have the opposite effect, causing a positive wealth effect and making it easier for companies to raise capital by issuing new shares.

The effects of ownership on businesses

1. The effects on mission

We saw in Chapter 1 that a business's mission sets out what it is trying to achieve, that is, the reason it exists. The type of ownership may have a considerable impact on the organisation's overall direction. Thus, for example, a public limited company is likely to have a mission that will allow it to provide sufficient financial rewards to its shareholders. Nike's mission is 'to bring inspiration and innovation to every athlete in the world'. Succeeding in this mission will allow the American sportswear company to produce popular and valued products that will generate high profits with which to reward its shareholders. In contrast, the Midcounties Co-operative, based in the English Midlands, strives to 'be a successful consumer co-operative working towards creating a better, fairer world and to enhance the lives of our colleagues, members, customers, and the communities we serve'. This mission is unlikely to result in the business seeking to maximise its profits but in operating in a way that benefits communities and many of its stakeholders.

2. The effects on objectives

A business's mission naturally gives rise to the objectives that it follows. Thus Nike may seek to achieve its mission by setting objectives relating to achieving a certain level of sales, producing innovative products regularly or being the leading company in its market. The Midcounties Co-operative may operate with objectives relating to the impact its business has on its stakeholders and the communities it serves.

Type of business	The effects on: Mission	Objectives	Decisions	Performance
Sole trader	May be unlikely to have a mission, but sole owner provides sense of direction.	May centre around meeting personal goals such as generating sufficient income.	Potentially rapid and responsive, but lacking support and possibly information.	Ownership allows business to be responsive to customers' needs, but may not be too price competitive.
Private limited company	Mission may centre on maintaining family-run business or on reputation.	Could relate to a satisfactory level of profits or financial stability to ensure continued survival.	More complex as more people likely to be involved. May have more information available and some specialist input.	Scale of this type of business varies hugely. Performance could be based meeting personal needs or on benefits of being large scale.

Type of business	The effects on: Mission	Objectives	Decisions	Performance
Public limited Company	Mission can play an important role to project the company's image and to provide a focus for consistent decision-making.	Likely to relate to costs, prices, business image and market share and link to financial performance in the longer term.	Can be very complex and have long-term implications. Some decisions require specialist input and need to be based on extensive information. Many routine decisions also need to be made.	Access to capital and pressure from shareholders likely to place emphasis on being competitive in terms of price, customer service or desirable products.
Not-for-profit	Mission can be important in establishing the ethos of the business and underpinning all decision-making.	Likely to be non-financial and can be less easy to measure such as benefiting the community or protecting the environment.	May lack specialists. Desire to meet social or other objectives may cloud judgements.	Probably measured in non-financial terms, but need to perform well enough financially to meet other goals.

Table 2.4 The effects of ownership

Business in focus: The Co-operative Group

The Co-operative Group started life as a small shop in Lancashire. It has since become Britain's largest mutually owned company and one of the longest-standing names on British High Streets. It employs over 100,000 people and has a diverse range of businesses, including grocers, financial products, funeral parlours and farming.

However, in 2013 a £1.5 billion hole was discovered in the finances of the Co-op bank and it declared a loss of £2.5 billion in 2014. In response to this the Co-op sold off various parts of its business. Its farms were sold to the charity The Wellcome Group for £249 million and its chain of pharmacies went to the Bestway Group for £620 million.

Big job cuts were also threatened in order to try and plug the hole in the group's finances – there were rumours that 4,000–5,000 jobs would be lost.

The cost-cutting measures caused much tension within the group as many members objected to the threat of job losses and of losing the parts of the business that they considered the 'crown jewels' of its portfolio. There was particular tension between the elected board members and the professional management of the group.

Source: adapted from various news sources

Questions

1. How should the Co-operative Group measure its performance?
2. Is a co-operative model suitable for managing a large organisation such as the Co-operative Group?

3. The effects on decisions

The type of business is likely to have an impact on the complexity of the decisions that have to be made as well as the speed of decision making. At times, public companies have to make major decisions with enormous implications for the business. In 2014, EE, the mobile telephone company which owns T-Mobile and Orange, announced that it was moving its call centre operations back to the UK from Asia. This will create 1,000 jobs in the UK but may increase the company's costs. Such a major decision would have been researched thoroughly beforehand to determine the effect of the decision on key stakeholders such as customers, employees and shareholders and may have taken time to complete because of this and the extent of communication involved. To an extent it is the scale of the business and its operations that determine the complexity and need for information and expertise in taking this type of decision, but most larger businesses are public companies.

At the other end of the scale, decision making can be a strength for small, sole trader businesses. Decisions are likely to be less complex and involve fewer participants, speeding and simplifying the process. This enables sole traders to be responsive to changes in their markets.

be more willing to offer loans to such companies, especially if they believe that the rising share price is the result of the business performing well. These arguments are particularly relevant if a company's share price is performing better than share prices generally.

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4. The effects on performance

The performance of a business can be measured in many ways, not just on its profits. It is influenced by a wide range of factors such as the state of the economy and technological changes, as well as the form of business that is adopted.

However, it is true to say that larger organisations, which are mainly public companies, may be able to produce at lower costs due to the use of specialist employees and up-to-date technology. This offers the potential to increase profits. Similarly, public companies may be more innovative (as they can spend large sums on researching new products) and this may enhance their performance, as in the case of Apple. Not-for-profit businesses may judge their performance in other ways, and not simply financially. Thus they may measure performance in terms of raising public awareness for an issue or on alleviating poverty.

ASSESSMENT ACTIVITIES

Sections (a), (b) and (c) of these assessment activities are relevant for students taking AS and A-level examinations. The questions in section (d) are for A-level students only.

(a) Knowledge check questions

1 State two reasons why an entrepreneur may choose to operate a business as a sole trader.

2 What is meant by the term 'unlimited liability'?

3 Is the following statement true or false? 'A company is owned by its stakeholders.'

4 State two differences between a private limited company and a public limited company.

5 What is meant by the term privatisation?

6 Finn plc has a current share price of 75 pence and has issued 725 million shares. It currently has £275 million in outstanding bank loans. What is its market capitalisation?

i) £543,750,000
ii) £54,375,000,000
iii) £286,750,000
iv) £54,100,000,000

7 What is the difference between a public company and a public corporation?

8 What are mutual businesses?

9 State two factors that might influence the share price of a public company.

10 Is the following statement true or false? 'If a public company's share price falls this immediately reduces the amount of capital available to the business.'

(b) Short answer questions

1 Explain one effect of a significant fall in a share price on the company concerned. (4 marks)

2 Explain why the owners of a private limited company might want to convert it to a public limited company. (5 marks)

3 Explain why sole traders are the most popular form of business in the UK. (5 marks)

4 Benacre plc manufactures a range of components for high technology products such as mobile phones. It is very profitable and has a rising share price. Explain two risks in buying shares in Benacre plc. (6 marks)

Chapter

18 Sources of finance

Introduction

This chapter builds on earlier ones and looks at a key decision that a business's managers have to make – that of deciding upon the most appropriate source of finance. It considers the various sources that are available to managers from inside and outside the business. The next chapter will look at other important decisions on how to improve profits or strengthen cash flow.

What you need to know by the end of this chapter:

- the internal and external sources of finance that are available to managers
- the advantages and disadvantages of different sources of finance for short- and long-term uses.

A number of sources of finance are available from which managers can select, but the one chosen will depend upon several factors:

- the amount of money required by the business
- the purpose for which the finance is required
- the time period over which the loan is required
- the legal structure of the business
- the financial position of the business.

We shall look at a range of sources of finance in this section and consider how factors such as those listed above may influence a business's choice of sources of finance.

Internal and external sources of finance

A source of finance refers to the way in which a business raises the finance that it needs for some activity. Sources of finance can be classified in a number of ways. **Internal sources of finance** already exist within a business and it only requires a decision about how to use it. Profits held over from previous years (known as retained profits) are an example of an internal source. **External sources of finance** are funds that are injected from outside the business. A bank loan is a prime example of this category of source of finance.

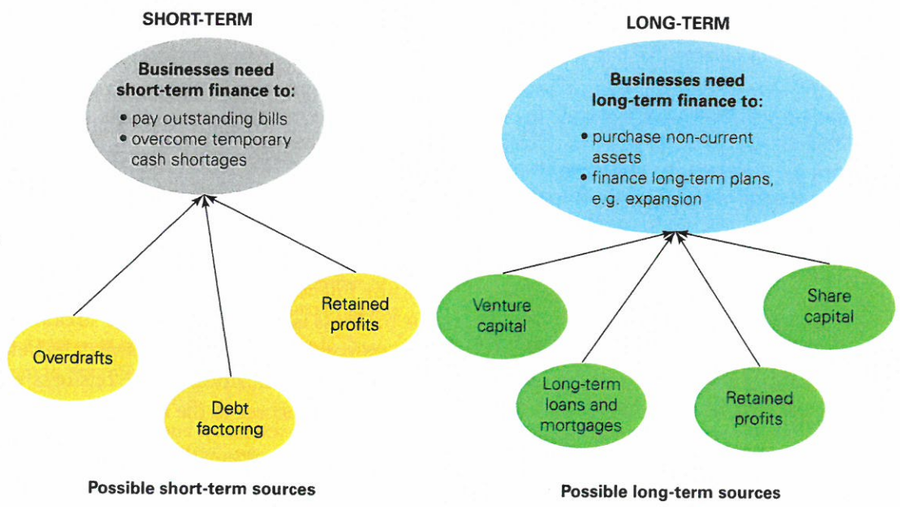

Figure 18.1 Why businesses need short- and long-term capital and how they meet those needs

It is also possible to classify sources of finance as short and long-term. A business may need **short-term finance** to pay its bills and to keep its suppliers happy, possibly covering a temporary shortage of cash. Sudden increases in the costs of raw materials can also create a need for short-term finance. Short-term finance of this kind is usually repayable within a one-year period.

However, businesses also need to purchase major capital assets such as land and buildings or to expand or to take over other businesses. To do this they will require **long-term finance**, which will be repaid over a period of time in excess of one year and on many occasions, much more than one year.

Table 18.1 classifies a range of sources of finance according to whether they are short- or long-term and internal or external.

	Internal sources of finance	External sources of finance
Short-term sources of finance	• Retained profits	• Overdrafts • Debt factoring
Long-term sources of finance	• Retained profits • Sale of assets	• Bank loans, mortgages & debentures • Venture capital • Share capital

Table 18.1 Classifying sources of finance in terms of time scale and source

Key terms

An **internal source of finance** is one that exists within the business

An **external source of finance** is an injection of funds into the business from individuals, other businesses or financial institutions.

Short-term finance is finance needed for a limited period of time, normally less than one year.

Long-term finance are those sources of finance that are needed over a longer period of time, usually over a year.

Internal sources of finance

An internal source of finance is one that exists within the business. The major internal sources of finance are retained profits and sale of assets.

1. Retained profits

This remains a major source of finance, particularly for smaller businesses. Businesses can use profits from the current trading year or profits from previous trading years (technically these are called retained profits) as sources of finance. By using profits for reinvesting, a business avoids paying interest on a loan and this can avoid heavy interest charges if the loan required is a large one. Furthermore, using this source of finance may avoid the need for a company to sell further shares, enabling existing shareholders to retain control if they continue to hold a majority of the shares.

But using retained profits can have substantial opportunity costs – that is the business may lose out from not using these profits in another way. Reinvesting retained profits may not be popular with shareholders, who are likely to receive a lower dividend as a result. Alternatively, the business may lose out on interest it may have received if it held the money in an interest-paying bank account.

This method of finance is only available to firms making a profit. Even then the profits may not be sufficient to purchase expensive capital assets. In 2014 EDF, the French-owned energy company, announced that it was reinvesting a sum equivalent to its £863 million operating profit from the current year, but this was insufficient to finance the £1.1 billion it invested into its nuclear and coal-powered electricity generating facilities. The company has invested £3.5 billion of its retained profits over the 2011–2014 period.

2. Sale of assets

Firms can raise finance by selling assets that they no longer require – normally these are **non-current assets**. The sale of some assets can raise large amounts of finance for businesses. Thus a business might have land, buildings or other assets that not required and they may decide to sell to raise capital. Shell, the multinational oil company, announced that it is to sell $15 billion of its assets in the 2014–2015 financial year to fund, among other things, its trading activities in North America.

Raising finance in this way offers a key benefit in that the business is not committed to a stream of future interest payments, nor might its shareholders suffer dilution of control. However, the business would normally lose access to the assets it has sold.

But what if the assets will continue to be required by the business? A popular technique of raising funds in recent years has been sale and leaseback. Under this arrangement firms sell valuable assets and lease them back again. This means that they have the capital from the sale of the assets as well as the continuing use of these assets, so that their business is not disrupted. The major drawback is that the business now has to pay for the use of assets that previously were freely available. This may have a negative impact on its long-term profits as well as its cash flow position.

Key term

Non-current assets are items that a business owns and which it expects to retain for one year or longer. Examples include property and vehicles.

External sources of finance

When individuals, other businesses or organisations such as banks or governments provide capital to a business, this is an external source of finance. Businesses are more likely to use external sources of finance when:

- a large sum of finance is required (as they will find it more difficult to raise such sums internally)
- the level of risk associated with the source of finance is low encouraging outsiders to invest or lend money
- the company's profit levels are relatively low reducing the possibility of the use of retained profits.

Key terms

A **bank loan** is an amount of money provided to a business for a stated purpose in return for a payment in the form of interest charges.

An **overdraft** exists when a business is allowed to spend more than it holds in its current bank account up to an agreed limit.

Venture capital is funds advanced to businesses thought to be relatively high risk in the form of share and loan capital.

Share capital is finance invested into a company as a result of the sale of shares in the business.

The first three external sources of finance we consider are all types of loan capital – finance that is borrowed. The major difference between them is the timescale of the borrowing. An overdraft may be taken out for just a few weeks whereas a business mortgage could last for up to fifty years. Loan capital can be attractive to a business as a source of finance because it does not lead to any loss of control by the owners of the business.

Study tip

A knowledge of the advantages and disadvantages of the various sources of finance will help you suggest and justify suitable sources in specific circumstances.

Business in focus: The Thomas Cook Group

The Thomas Cook Group plc is a British registered company that sells holiday products to over 19 million customers worldwide each year. The company's management team has announced its intention to reduce the amount of debt the company holds and has been seeking the best source of finance to do this. The company operates with the primary aim of achieving sustainable, profitable growth.

In 2012 the Thomas Cook Group agreed a number of sale and leaseback deals for some of its non-current assets.

- It raised £11.5 million by selling its offices in Ghent in Belgium to Koramic Real Estate and leasing them back again.
- The Group signed a sale and leaseback deal with several other companies. This resulted in the sale and immediate leaseback of 19 aircraft, resulting in the company raising £182.9 million.

In 2014 the company announced further sales of assets. It received £13.5 million from selling its corporate travel business and a further £14.3 million from selling Elegant Resorts, its luxury travel enterprise. The Thomas Cook Group's share price has risen from 16.5 pence in May 2012 to 127.8 pence in August 2014.

Questions

1. Explain why the Thomas Cook Group might have wanted to reduce the amount of debt (or borrowing) that it had.
2. Evaluate whether sale and leaseback is the best choice as a source of finance for Thomas Cook Group plc in these circumstances.

1. Overdrafts

An **overdraft** is perhaps the best-known method of short-term finance. An overdraft is a facility offered by banks allowing businesses to borrow up to an agreed limit for as long as it wishes. Overdrafts are a very flexible form of finance as the amounts borrowed can vary so long as they are within an agreed figure. They are also simple to arrange – established business customers can often arrange, or increase the limit, without completing any forms.

However, overdrafts can be quite expensive with interest being charged at between 4 and 6 per cent over the bank's normal lending rate on a daily basis. This is not a problem unless a business seeks to borrow on overdraft over a long period of time. In these circumstances it might be better for a business to convert their overdraft to a longer-term method of finance. A further drawback of using overdrafts as a source of finance is that banks can demand immediate repayment.

2. Debt factoring

Debt factoring is a service offered by banks and other financial institutions. If businesses have sent out bills (also termed invoices) that have not yet been paid they can 'sell' these bills to gain cash immediately. Factoring debts in this way provides up to 80 per cent of the value of an invoice as an immediate cash advance. The financial institution then organises the payment of the invoice and makes a further payment to the business concerned. It is usual for the financial institution to retain about 5 per cent of the value of the invoice to cover its costs in debt collection. The process is summarised in Figure 18.2.

Many small firms believe that to lose up to 5 per cent of their earnings makes factoring uneconomic – this can eliminate much of their profit margin. Their customers are also likely to be aware that the debts have been factored, which may cause them to worry about the business's ability to manage its short-term finance. They may seek other suppliers if they believe the business is financially unstable.

However, debt factoring does offer a number of benefits.

- The immediate cash provided by the factor means that the firm is likely to have lower overdraft requirements and will pay less interest.
- Factoring means businesses receive the cash from their sales more quickly.

Debt factoring has become more popular for businesses, especially small and medium-sized ones (SMEs) as overdrafts have become more difficult to arrange. We consider this development further in the Business in Focus feature about UK banks.

3. Bank loans, mortgages and debentures

Bank loans can usually be arranged if the business that is seeking the credit is financially sound and has a satisfactory financial history. The financial institution advances the business a set figure and the business makes repayments over an agreed period of time. If the bank lending the capital considers the loan in any way risky, then it is likely to charge a higher rate of interest. Small businesses, in particular, suffer from this effect. Normally banks charge about 2 per cent over their base rate of interest for loans such as these. Interest rates can be fixed or variable.

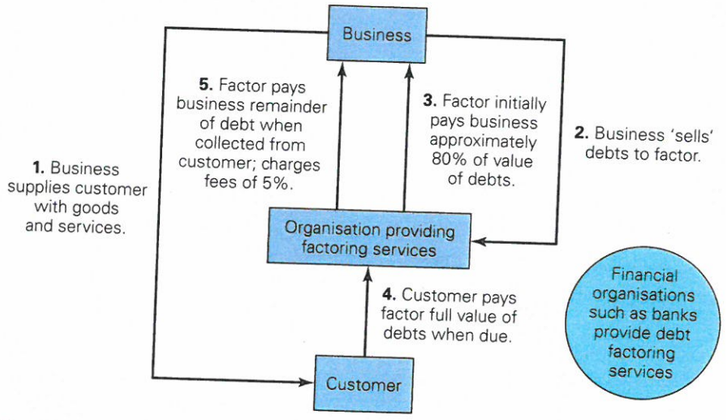

Figure 18.2 The process of debt factoring

Business in focus: UK banks withdraw overdraft facilities

Small and mid-sized enterprises (SMEs) have traditionally relied heavily on overdrafts, which account for half of the financial products traditional banks have offered to SMEs. They were popular due to them being able to be arranged easily, being cost effective and being a flexible way of borrowing money. Research from Platform Black, a finance company, suggested that 56 per cent of businesses surveyed had relied on their overdraft facility in the last two years.

However, the same research suggests that traditional lenders have been withdrawing overdraft services for SMEs. In 2011 overdrafts accounted for 25 per cent of all finance used by SMEs but by 2013 this had fallen to 16 per cent. Lending via overdraft to small and mid-sized enterprises fell by £800 million in December 2013 alone.

The withdrawal of overdrafts by banks can be devastating to SMEs, especially because banks can do it at very short notice. In the absence of being able to secure sufficient overdrafts, businesses have been relying on other forms of finance including credit cards, bank loans and hire purchase.

Source: adapted from various news sources

Questions

1. Explain why having short-term sources of finance available is important for small and medium-sized businesses.
2. Do you think that overdrafts are the best short-term source of finance available to businesses? Justify your opinion.

Key terms

Mortgages are long-term loans, repaid over periods of up to fifty years, and used to purchase property.

Debentures are loans with fixed interest rates that are long-term and may not even have a repayment date.

Banks will often require security for their loans and this will usually be in the form of property. Such security is often termed 'collateral'. If the business defaults on the loan the bank sells the property or other collateral and recoups the money that was lent. In this way the bank lowers the degree of risk it incurs in making loans to businesses.

There are different types of loans available to businesses.

- **Mortgages.** Mortgages are simply long-term loans granted by financial institutions solely for the purchase of land and buildings. The land or building in question is used as security for the loan – they act as collateral and will be sold to recover the money lent, if the borrower stops repayments. These loans can be for long periods of time – often in up to fifty years. Mortgages can have fixed or variable rates of interest and are particularly suitable when a business wishes to raise large sums of money.

  Some businesses may choose to remortgage their premises to raise capital. A remortgage either increases the existing mortgage or establishes a mortgage where one did not exist before. This is a source of finance particularly popular with small businesses.
- **Debentures.** Debentures are a special type of long-term loan to be repaid at some future date, normally within fifteen years of the loan being agreed. The rate of interest paid on debentures is fixed. In some circumstances debentures may not have a repayment date, representing a permanent loan to the business. This is an irredeemable debenture. Debentures are normally secured by using the business's non-current assets as collateral. Debentures are a form of loan capital and holders of debentures do not have voting rights in the business.

  The All England Lawn Tennis Club has issued debentures to help it to fund improvements to centre court and its other facilities at Wimbledon. These are particularly popular with tennis fans as tickets for the Wimbledon tennis tournament are included in the deal.

4. Venture capital

Venture capital is an important source of finance for small enterprises and for businesses that are considered to be risky and therefore in some danger of failing. It is normally a mix of loan and share capital. Financial institutions, for example merchant banks, provide venture capital as well as individuals (who are known as business angels).

Organisations and individuals providing venture capital frequently wish to have some control over the organisation for which they are providing finance. The business's owners may need to sell some shares in their companies (generally a minority stake) to the person or organisation providing the venture capital. Providers of venture capital may seek a non-executive director role in the business in which they are investing. Venture capital investors not only provide capital, but experience, contacts and advice when required, which distinguishes venture capital from other sources of finance.

A significant drawback is that providers of venture capital will not advance huge amounts to businesses. It is unusual for venture capitalists to lend in excess of £500,000 in a single deal. Despite this, Pinterest, an image-sharing social website, has raised $425 million from a number of venture capital companies to finance its expansion online. The size of this deal reflects the potential that venture capitalists believe lies in Pinterest.

Weblink

Find out more about venture capital by visiting the website of the British Venture Capital Association at www.bvca.co.uk/

5. Share or equity capital

This is a very common form of finance for both start-up companies and for established ones. Companies raise capital by selling, quite literally, a share in their business to investors. A share is simply a certificate giving the holder ownership of part (or a share) of a company. The shareholders purchases shares and by selling large numbers companies can raise significant sums of capital. Issuing shares can be very expensive, which means it is only appropriate for raising large sums of capital.

Share capital is a source of finance for both private limited companies and public limited companies. However, in the UK, it is much easier for public limited companies to sell shares for two reasons:

1. They can sell shares on the Stock Exchange. This is an efficient international market which brings together buyers and sellers of shares and sets share prices.
2. Unlike private limited companies, public companies do not need the permission of other shareholders to sell shares. Equally existing shareholders can sell their shares freely.

Both these factors make it easier to buy and sell shares in public limited companies and encourage shareholders to buy shares in the first place.

There are several benefits from the selling of shares or equity as a source of finance. Although the companies will be expected to pay an annual return to shareholders (dividends) the level of this payment is not fixed and in an unprofitable year it may be possible for the company to avoid making any payment. It can be used to raise large sums of capital, as in the case of UK airline group flybe. In February 2014 flybe announced that it was to offer shares for sale to the value of £155.1 million to finance the company's expansion plans. The company is investigating 100 new possible routes for its aircraft to fly.

However, there are disadvantages of using share capital as a source of finance. Clearly it is only available to companies. Private limited companies have to seek approval from existing shareholders before issuing further shares. The most significant disadvantage is the potential for loss of control. If a business issues too many shares it may dilute the control of the existing owners to the point where new shareholders have a majority, and controlling, interest in the business.

Business in focus: Crowdfunding – a different source of finance

Figure 18.3 Crowdfunding can finance expansion

George Christakos owns and manages a restaurant in Nova Scotia in Canada and, facing the normal difficulties in raising capital, decided to use his business's customers as a source of finance. He wanted to enlarge the restaurant in the town of Halifax, a restaurant that he co-owns with his father, Leo. George's first choice as a source of finance, the Bank, decided not to lend him any money.

Not dismayed, George and his father decided to use crowdfunding to raise the finance they needed. This is a source of finance that invites small contributions from a large number of people.

Mr. Christakos' crowdfunding effort was unique, but entirely suitable for his business, and comprised three options for his customers. For investing $50, a customer was rewarded with lunch for two and two T-shirts. The option of a four-course dinner for two for $100 proved to be the most popular. For customers with larger sums to invest, George offered two dinners a year for the rest of the restaurant's life.

Using crowdfunding as a source of revenue, the restaurant raised $23,000 from 115 contributors, 80 per cent of whom lived close to the restaurant. Crowdfunding campaigns can take many different forms. Some involve donations, while others, such as Mr. Christakos' effort, involve the pre-purchase of goods or services. In any event the goal is to raise capital.

Source: Compiled from a variety of sources including the *Financial Post*, 22 October 2012

http://business.financialpost.com/2012/10/22/equity-crowdfunding-source-of-innovation-capital-for-startups/

Questions

1. Explain why a loan from the Bank might have been George Christakos' first source of finance.
2. Discuss the major advantages and disadvantages for George of using crowdfunding as a source of finance.

6. Other sources of finance

The increasing role and importance of the internet has acted as a catalyst for the development of new sources of finance. It has allowed the owners of businesses to communicate with a large number of people and to appeal directly for finance for their enterprises. The Business in Focus feature about **crowdfunding** illustrates an example of a restaurant raising a relatively small sum of capital.

There are also more established businesses operating online with the intention of providing a source of finance for businesses. These are termed peer-to-peer lenders and raise money from large numbers of private investors to lend to businesses for specific projects. The peer-to-peer lenders undertake some assessment of the risks entailed with the loan and administrate the process in return for fees. Funding Circle and Zopa are among the UK's best-known examples of peer-to-peer lenders.

Weblink

Find out more about Funding Circle by using the link below and clicking on the 'about us' tab.
www.fundingcircle.com

Key term

Crowdfunding is practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the internet.

Choosing a source of finance

In the previous sections we have seen that all sources of finance, whether internal or external, short or long term, have advantages and disadvantages. These are summarised in Table 18.2 on page 240.

Source of finance	Advantages	Disadvantages
Overdrafts	• A flexible way of funding day-to-day financial requirements. • Interest is only payable on the actual amount borrowed.	• Interest rates are high. • Bank may ask for repayment at any time. • May not be available to some SMEs.
Debt factoring	• It allows businesses to receive cash almost immediately a sale is made. • It may reduce a business's overdraft and interest charges.	• It can reduce or even eliminate a business's profit margin, if it is small. • Customers may be aware if debts are factors and could lose faith in the supplier.
Bank loans	• Can be negotiated to meet a business's precise requirements. • Managers can plan for repayments within budgets.	• They are inflexible and businesses may pay interest on funds they are not using. • Businesses may be required to offer collateral.
Mortgages and debentures	• These are ideal sources of finance for very long-term projects. • They avoid the owners losing any control over the business.	• Managers will have to offer property as collateral for mortgages. • Businesses can pay large amounts of interest on very long-term loans.
Retained profits	• They are a 'free' source of finance as they do not incur interest charges. • They do not involve any potential loss of control by a business's owners.	• The owners of the business (e.g. shareholders) may wish to receive the profits. • The business may lose out on valuable alternative investments.
Share capital	• It can be used to raise very large amounts of capital. • The company is not committed to fixed interest payments.	• This source of finance is only available to companies. • Private limited companies can only sell additional shares with shareholder approval. • Existing owners may lose control of the company.
Venture capital	• Can bring expertise into the business as part of the deal. • Avoids having to pay interest on the entire amount of finance.	• Some entrepreneurs and owners may not wish to have venture capitalists involved in decision-making. • Usually only able to raise small amounts of finance.
Crowdfunding	• Can be a relatively cheap source of finance • Increasingly relevant as UK banks reduce short-term lending.	• Unfamiliar source of finance for many managers. • May not be suitable to raise very large amounts of capital.

Table 18.2 Some advantages and disadvantages of selected sources of finance

Managers can select the most appropriate source of finance by considering the advantages and disadvantages of each available source and making a decision on which is most appropriate for their circumstances. There are a number of factors that managers will need to take into account, as summarised in Figure 18.4.

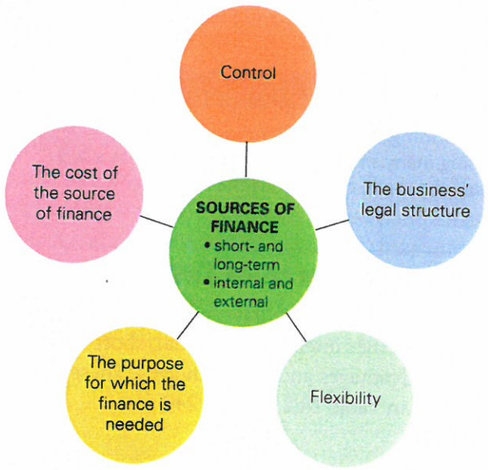

Figure 18.4 The factors that influence managers' decisions on sources of finance

The influences on decisions on sources of finance

1. The business's legal structure

The legal structure of a business is a major influence of the sources of finance that are available to a business.

Start-up businesses, many of which may be sole traders or partnerships, normally have a more limited range of sources of finance to draw upon as they represent a greater risk to potential investors and have few, if any, internal sources of finance for use.

In contrast a public limited company has a greater range of sources of finance that it can use and, in particular in the UK, they benefit from being able to raise capital by selling shares on the London Stock Exchange.

2. The cost of the source of finance

The costs incurred by firms raising capital can take a number of forms.

Legal form of business	Possible sources of finance	Key issues for consideration
Sole trader	Owner's savings, banks, suppliers, Government grants and loans.	• Security for those lending funds • Loss of control by owner • Evidence that business has potential to develop • Financial history of business/owner
Private Limited Company (Ltd)	Dependent upon the size of the private limited company, suppliers, banks, Government grants and loans, venture capital institutions, private share issues.	• Disagreement among existing shareholders • Difficulty finding suitable shareholders • Loss of control by existing shareholders • Lack of collateral and security for those lending funds • Element of risk in the loan
Public Limited Company (plc)	Suppliers, banks, Government grants and loans, venture capital institutions, public share issues via the Stock Exchange.	• State of economy and stock market • Ability to move to area receiving government aid • Recent financial performance • Reputation of company and senior managers

Table 18.3 The legal structure of a business, possible sources of finance and key issues

(a) **The rate of interest.** The rate of interest charged by organisations granting loans can be a significant influence, especially if the loan is a large one. This will depend on the level of risk that the loan represents to the lender and the time period of the loan. A short-term loan to a high-risk business might be charged at a high rate of interest.

(b) **The costs of selling shares.** For a public limited company a share issue can be an attractive option, although this can be an expensive method of raising capital as it entails considerable administration and promotion and, on occasions, a form of insurance if the sale is not successful. When shares are first sold by a company it has to use the services of other expert organisations to organise the sale. It is common for companies to use merchant banks for this purpose.

Public limited companies sometimes use rights issues to sell new shares. A rights issue entails selling additional shares to existing shareholders in proportion to the number of shares already owned. For example, existing shareholders may be offered the opportunity to buy one new share for each eight already held. Because of the relatively low cost of issuing shares in this way it is usual for them to be sold at a slight discount to encourage purchases.

Key term

Opportunity cost is the next best alternative that is foregone.

Study tip

Do not confuse the sale of new shares and second hand ones. Firms sell newly issued shares directly to the shareholders. In contrast, second-hand shares are sold mainly through the Stock Exchange. When second-hand shares are sold on the Stock Exchange it is not a source of finance for the company whose shares are sold – it is merely a means of the shareholder recovering the investment by selling the shares to another person or organisation.

(c) **Opportunity cost.** A decision to use a particular source of finance may have a cost in terms of what has to be given up as a consequence of the decision. For example, using retained profits for reinvestment into the company entails an opportunity cost which can be measured in terms of the reduction in the amount of profits that can be paid to shareholders (these are known as dividends).

For many businesses, accessing sources of finance at the lowest possible cost is the most important factor.

3. Flexibility

Some sources of finance are highly flexible and can be adapted to meet a business's precise needs. The most obvious example is an overdraft. This source of finance allows a business to overspend in its current account (or not) according to its needs (but subject to an overall limit). Thus a business can use its overdraft only when it is necessary and can avoid any interest charges at times when its finances are stronger. This flexibility has a price however: overdrafts are an expensive source of finance.

4. Control

Some sources of finance may result in the original owners of the business losing some, or even complete control of it. Certain forms of finance are only available if the person or organisation investing gains a say in how the business is managed. This is perhaps most obvious in the sale of shares. If a private or public limited company makes a succession of share issues it may be that the number of new shares issued is greater than the number of 'original' shares. In this case the new shareholders may gain control of the company.

However, it may be possible for the company to issue shares that do not carry full voting rights. This can allow the original shareholders to retain control though, of course, it makes the issue of new shares much less attractive to potential shareholders.

Smaller businesses that do not trade as companies can also lose some degree of control if they opt to use certain sources of finance. For example, venture capitalists may only agree to provide finance to what may be considered a risky business if a part of their investment is in the form of shares and they have a say in the management of the business.

5. The purposes for which the finance is needed

Some sources of finance are suitable in certain situations. Thus, for example, a business that is seeking to raise finance to purchase property and has to rely on loan finance will probably consider taking out a mortgage. A mortgage is a long-term loan (and can be available at relatively low rates of interest) and the combination of these two factors makes it an ideal source of finance to purchase property, which can be very expensive.

In contrast, if the finance is being raised to fund a risky start up then an entrepreneur may experience difficulties in finding investors willing to put capital into the business. In this situation a venture capitalist may be the best choice as this source of finance specialises in investing in relatively high-risk enterprises and may also provide support and guidance to novice entrepreneurs.

ASSESSMENT ACTIVITIES

Sections (a), (b) and (c) of these assessment activities are relevant for students taking AS and A-level examinations. The questions in section (d) are for A-level students only.

(a) Knowledge check questions

1. State the difference between a short-term and a long-term source of finance.
2. Is the following statement true or false? 'A major consideration when deciding whether or not to use retained profits as a source of finance is opportunity cost.'
3. What is meant by the term overdraft?
4. State two reasons why a manager might be reluctant to use debt factoring as a source of finance.
5. State two features of a bank loan.
6. Is the following statement true or false? 'Venture capital is not suitable as a source of finance for start-up or small businesses.'
7. State two types of businesses that can use share capital as a source of finance.
8. State two possible advantages of using retained profits as a source of finance.
9. State two disadvantages of using overdrafts as a source of finance.
10. State two factors that might influence a manager's decision on which source of finance to use.

Name:

A Level Business Bridging Work

Tasks to be completed for A Level Business Bridging work:

Task 1-**Read the resource on Note-taking (Appendix 1)** to understand thedifferent methods of Taking notes and Making notes.

Do not complete Tasks 2 and 3, without completing Task 1 first!

Task 2-Using one of the **note-taking methods from the resources provided in Appendix 1,** make notes on **Business Ownership**, using the **website link** belowand the textbook chapters from **Appendices 2.1 and 2.2**.

https://www.tutor2u.net/business/reference/business-organisation-introduction-to-business-ownership

Task 3-Using one of the **note-taking methods from the resources provided inAppendix 1,** make notes on **Sources of Finance**, using the **website link** on the**Task 3 sheet** and **Appendix 3.**

https://www.tutor2u.net/business/reference/sources-of-finance-for-a-startup-or-small-business

Task 4-Choose one of the following tasks:

Netflix-Watch the documentary **'American Factory'** and consider arguments **'For'** and **'Against'** big US businesses in moving their production to China. Using the weight of both arguments, **evaluate** whether US businesses can justify moving their production to China.

OR

Spotify and BBC Sounds-Listen to **5 business-related podcasts** from **'50 Things That Made the Modern Economy'** - Tim Harford and summarise eachpodcast.

All tasks are to be completed by **W/C 6 Sepember 2021.**

Appendix 1

Bridging Work Resource Sheet for A-level Businessand Economics.

An Introduction to the Skill of Note-taking: TakingNotes and Making Notes

During your A-level studies, and indeed your degree, you will be expected to make sense of the many hours of teaching/lecturing you receive, and any further reading/research that you have completed. The best and most efficient way of coping with so much information isto **take notes** at the time, from which further (and better) **notes can be made** when they are needed (such as for **revision**).

There are many methods of taking notes and you must choose the stylethat best suits you. In the lesson/lecture there are many styles of note-taking available to students and these will largely be determined by the format of the presentations you receive. Many A-level teachers provide handout material to assist your note-taking **('guided notes method')**: such resources encourage active learning by providing a framework of headings for you to understand the main elements of thetopic, whilst requiring you to fill in some of the details and examples as they are being explained.

In the absence of supporting materials, you need to develop a style that will best enable you to filter the most important points, explanations and examples from the session, whether that be in a **linear written form** (using shorthand, where necessary: see the following guide developed by the University of Portsmouth (http:// tinyurl.com/psu4cyt) or through a **non-linear method**, perhaps including visual cues, such as mapping ideas as they develop. Whatever you choose, the method needs to capture the essential points of the lesson/lecture and filter out the digressions, anecdotes and asides thatare not directly relevant to learning the topic.

Cornell method of note-taking

This refers to a method popularised by Professor Walter Pauk at this American Ivy League university in the 1950s, which may be used for lessons/lectures but strikes me as especially useful for making sense offurther reading and research, and building on earlier notes, to achievea greater degree of understanding and synthesis of a topic. It involves dividing the page into two columns, with the one on the right much larger than the one on the left. The left is used for key words/terms/ headings; the right is used for explanations and examples, in shorthandwritten form. The last few lines of the page are meant to be left blankfor questions or for a short summary of the session – but I would reserve this for the end of your topic notes rather than for every page.

Notes should be frequently reviewed, added to and re-made in theimportant transformation process that has to take place during therevision process.

Note-taking: the top five

- Remain active in lessons/lectures by taking detailed notes
- Adopt a style that best suits you – linear notes or non-linearmapping?
- Use shorthand where possible to increase the efficiency of yournote-taking – and ensure that you capture everything you need

Review, add to and re-make your notes

- Transform your notes for revision

Introductory Tasks common to all subjects

Visit the University of Bradford's note-taking page to find resources and specific guidance on the Cornell method: http:// www.bradford.ac.uk/academic-skills/writing/study/effective-learning/note/