

OXFORD IB DIPLOMA PROGRAMME



2014 EDITION

BUSINESS MANAGEMENT

COURSE COMPANION

Martin Muchena
Loykie Lomine
Robert Pierce

OXFORD

3 FINANCE AND ACCOUNTS

3.1 Sources of finance

By the end of this chapter, you should be able to:

- explain the role of finance for businesses in terms of **capital expenditure** and **revenue expenditure**
- comment on the following internal sources of finance: **personal funds**, **retained profit** and **sale of assets**
- comment on the following external sources of finance: **share capital**, **loan capital**, **overdrafts**, **trade credit**, **grants**, **subsidies**, **debt factoring**, **leasing**, **venture capital** and **business angels**
- define **short-**, **medium-** and **long-term finance**
- discuss the appropriateness, advantages, and disadvantages of sources of finance for a given situation.

All forms of business organization need funding for the various activities they undertake. The money could be needed for a variety of reasons, including starting a business, for its day-to-day operations, or for its future growth and expansion. As a result, businesses need to ascertain or be clear on the exact purpose of their finance. This purpose can be classified as either **capital expenditure** or **revenue expenditure**.

Capital expenditure

This is money spent to acquire items in a business that will last for more than a year and may be used over and over again. Such items are known as **fixed assets** and include machinery, land, buildings, vehicles, and equipment. These fixed assets are needed for the purpose of generating income for the business over the longer term. Due to their high initial cost, most fixed assets can be used as **collateral** (financial security pledged for repayment of a particular source of finance such as bank loans). Capital expenditures are therefore long-term investments intended to assist businesses to succeed and grow. For example, purchasing a van by a business is termed capital expenditure because the benefits accrued to the business from this will be spread over the long term.

Revenue expenditure

This is money spent on the day-to-day running of a business. These payments or expenses include rent, wages, raw materials, insurance, and fuel. They do not involve the purchase of longer-term, fixed assets. Revenue expenditure needs to be covered immediately to keep the



business operational and should therefore provide immediate benefits, unlike capital expenditure which has a long-term focus. Businesses need to be cautious not to have consistently high revenue expenditure as this will make it difficult for them to build sufficient capital in order to make long-term investments. In addition, it may make it extremely difficult for them to get out of a sudden crisis situation. For example, if a school is spending most of its money paying salaries and bonuses to teachers or paying food suppliers, and these costs are not checked, it may be unable to build new classrooms to accommodate any increases in student demand. In a business, a high level of expenses may also erode the profits.

Student workpoint 3.1

Be a researcher

Choose any two multinational companies that you are interested in. Using the Internet or any other available resource, find out for each company what its main capital and revenue expenditures are. Separately list each company's expenditures on a table.

The sources of finance for a business can be obtained from either internal sources or external sources.

Internal sources of finance

Internal finance is money obtained from within the business and is usually from already established businesses. Some of these sources include the following.

Personal funds

This is a key source of finance for sole traders and it comes mostly from their own personal savings. By investing with their personal savings, sole traders maximize their control over the business. In addition, this investment shows commitment to the business and is a good signal to other investors or financial institutions that the business might need to approach for additional sources of finance. It is a preferred source of finance because it is cheap and easily available, and no interest will need to be paid. However, it poses a great risk to the owners or sole traders because they could be investing their life's savings. In addition, if these savings are not large it may prove difficult to start or maintain a business, especially if this is the only source of funding.

Retained profit

This is the profit that remains after a business has paid tax to the government (corporation tax) and dividends to shareholders. It is also known as **ploughed-back profit** and it is reinvested into the business, becoming an important source of finance for the organization. Most businesses use retained profit for expansion, which includes the purchase of fixed assets, or they spend it on research and development. The advantages of retained profit include the following.

Key terms

Capital expenditure

money spent to acquire fixed assets in a business

Revenue expenditure

money used in the day-to-day running of a business

Key terms

Personal funds

a source of finance for sole traders that comes mostly from their own personal savings

Retained profit

profit that remains after a business has paid corporation tax to the government and dividends to shareholders



- It is cheap because it does not incur interest charges.
- It is a permanent source of finance as it does not have to be repaid.
- It is flexible as it can either be kept as cash in the bank or spent in a way the business deems fit.
- The owners have control over these funds without interference from other financial institutions such as banks.

However, there are some disadvantages:

- Start-up businesses will not have any retained profit as they are new ventures.
- If retained profit is too low, it may not be sufficient for expansion.
- In some cases owners may overuse the retained profit and leave no buffer for emergencies or for future growth opportunities.
- A high retained profit may mean that either very little or nothing was paid out to shareholders as dividends.

Sale of assets

This is when a business sells off its unwanted or unused assets to raise funds. These assets that are no longer required by the business include obsolete machinery or redundant buildings. To raise cash, businesses could also sell off any excess land or equipment they may not be using. The advantage of selling assets is that it is a good way of raising cash from capital that may be tied up in assets that are not being used. No interest or borrowing costs are incurred. The drawback is that it may only be an option available to established businesses and not new ones that may lack any excess assets to sell. In addition, it may be time-consuming to find a buyer to sell the assets to, especially in the case of obsolete machinery. In some cases businesses may adopt a **sale and lease back** option, which involves selling an asset that the business still needs to use. In this case the business will sell the asset to a specialist firm that then leases the asset back to the business.

Key term

Sale of assets

when a business sells off its unwanted or unused assets to raise funds

Student workpoint 3.2



Be a researcher

Using an Internet search engine such as Google, find at least five organizations that rely to a large extent on internal sources of finance to operate. What are the main internal sources they use, and why?

External sources of finance

External finance is money obtained from sources outside the business. These could be from institutions or individuals willing to provide the funds. Some of these external sources of finance include the following.

Key term

Share capital

money raised from the sale of shares of a limited company

Share capital

This is money raised from the sale of shares of a limited company and is also known as **equity capital**. Buyers of these shares are known as **shareholders** and may be entitled to dividends when profits are made. The term **authorized share capital** suggests the maximum amount the shareholders of a company intend to raise. Unlike private limited company shares that are not sold to the public, the shares of public limited companies are sold in a special share market known as the **stock exchange**. This is a regulated and organized market where securities (for example shares and bonds) are purchased by and sold to willing investors. The oldest stock exchange in the world is the London stock exchange. Other global exchanges include Bombay, Tokyo, Nairobi, Johannesburg, and New York stock exchanges. The advantage of share capital as a source of finance is that it is a permanent source of capital as it will not need to be redeemed (repaid by the business). Another is that there are no interest payments and this relieves the business from additional expenses. On the other hand, shareholders will expect to be paid dividends when the business makes a profit. In addition, for public limited companies the ownership of the company may be diluted or change hands from the original shareholders to new investors or shareholders via the stock exchange.



Loan capital

Also known as **debt capital**, this is money sourced from financial institutions such as banks. Interest is charged on the loan to be repaid; however, these repayments (installments) are usually spread evenly until the full loan amount (principal plus interest) is paid. The interest rates may be either fixed or variable. A **fixed interest rate** is one that does not fluctuate and remains fixed for the entire term of the loan repayment. A **variable interest rate**, on the other hand, changes periodically based on the prevailing market conditions. The advantage of this source of finance is that it is accessible and can be arranged quickly for a firm's specific purpose. Its repayment is spread out over a predetermined period of time, reducing the burden to the business of having to pay it in a lump sum. Large organizations can negotiate for lower interest charges depending on the amount they wish to borrow. The owners still have full control of the business if no shares are issued to dilute their ownership.

However, there are drawbacks. The capital will have to be redeemed even though the business is making losses and in some cases collateral (security) will be required before any funds are lent out. Failure to pay the loan may lead to the seizure of a firm's assets. If variable interest rates increase, a firm that took this option may be faced with a high debt repayment burden.

Overdrafts

This is when a lending institution allows a firm to withdraw more money than it currently has in its account, which is called overdrawing from the account. In most cases the overdrawn amount is an agreed amount that has a limit placed on it. Interest is charged only on the amount overdrawn. However, exceeding the limit set may attract higher

Key terms

Loan capital

money sourced from financial institutions such as banks, with interest charged on the loan to be repaid

Overdrafts

when a lending institution allows a firm to withdraw more money than it currently has in its account



additional costs. The advantage of a bank overdraft is that it provides an opportunity for firms to spend more than they have in their account (even in situations where there is no money in the account), which greatly helps in settling short-term debts such as paying suppliers or the wages of staff. It is a flexible form of finance as its demand will depend on the needs of the business at a particular point in time. Charging interest only on the amount overdrawn may make it even cheaper than loan capital. With an overdraft facility, banks can cover a firm's cheques to prevent them from bouncing. The major drawback is that banks can ask for the overdraft to be paid back at very short notice. In addition, due to the variable nature of an overdraft, the bank may at times charge high interest rates.

Trade credit

This is an agreement between businesses that allows the buyer of goods or services to pay the seller at a later date. In essence, no immediate cash transaction is done at the time of trading. The credit period offered by most creditors (trade credit providers) usually lasts from 30 to 90 days; jewellery businesses are known to extend it to at least 180 days. A major advantage of trade credit is that by delaying payments to suppliers, businesses are left in a better cash-flow position than if they paid cash immediately. It is also an interest-free means of raising funds for the length of the credit period. A disadvantage is that debtors (trade credit receivers) lose out on the possibility of getting discounts had they purchased by paying cash. In addition, delaying payment to creditors after the agreed period may lead to the development of poor relations and suppliers may even refuse to engage in future transactions with the debtors.

Grants

These are funds usually provided by a government, foundation, trust, or other agency to businesses. In order to receive a grant, businesses will be expected to write a proposal showing how they plan to use the money. In most cases **grant makers** (providers of the grant) are very selective on who receives the grant. Governments, for example, would prefer to offer grants to businesses that agree to set up in areas of high unemployment so as to improve the welfare of people living in that area. Foundations such as the Bill and Melinda Gates Foundation offer most of its grants to US-based organizations including other tax-exempt organizations, with a focus on promoting social responsibility. A key advantage of a grant is that it does not have to be paid back by the recipient. The downside is that it mostly comes with "strings attached" depending on the objective of the grant maker.

Subsidies

A subsidy is financial assistance granted by a government, a non-governmental organization (NGO) or an individual to support business enterprises that are in the public interest. Farm subsidies are common subsidies given to domestic farming industries. In most cases the cash subsidies are given to help these industries survive in a very competitive

Key terms

Trade credit

an agreement between businesses that allows the buyer of goods or services to pay the seller at a later date

Grants

funds usually provided by a government, foundation, trust, or other agency to businesses that do not need to be repaid

Subsidies

financial assistance granted by a government, a non-governmental organization (NGO), or an individual to support business enterprises that are in the public interest

environment by being able to sell their produce at low market prices, while still being able to reap financial gain. In situations where the market price goes below the cost of production, this is known as **subvention**. A major advantage of granting subsidies is that it helps businesses to increase their demand for goods by charging lower prices for their products. Like grants, subsidies do not need to be repaid. A drawback, especially with government subsidies, is that they are often marred by political interference in the subsidization process.

Debt factoring

This is where a business sells its invoice to a third party known as a debt factor. It is a financial arrangement where the factor takes on the responsibility for collecting the debt owed to the business. The debt factor may immediately pay the business between 80–90 per cent of the money owed on the invoices and then proceed to collect the full amount from these debtors. The remaining 10–20 per cent of sales revenue counts as part of the debt factor's profit. The higher the debt owed the more willing the debt factors will be to pay upfront, due to the possibility of getting a higher percentage profit. An advantage of debt factoring is that a business gets immediate cash that it can use to fund other activities or projects. In addition, the risk or responsibility of collecting the debt is passed on to the factor. The disadvantages are that a business loses a percentage of its profits because it does not receive the full debt repayment and debt factors are known to charge high administrative and service fees to do their job. In addition, a business may risk losing a loyal customer if the debt factors use harsh means of collecting debt such as threatening to take the customer to court for failing to pay the debt.

Leasing

This is where a business (lessee) enters into a contract with a leasing company (lessor) to acquire or use particular assets such as machinery, equipment, or property. This allows a firm to use an asset without having to purchase it with cash. Periodic or monthly leasing payments are made by agreement between the lessor and lessee. In some cases businesses may get into a **finance lease** agreement where, at the end of the leasing period, which usually lasts for more than three years, it is given the option of purchasing the asset. Large organizations such as airlines and electronic and car companies are known to lease their assets. A major advantage of leasing is that a firm does not need to have a high initial capital outlay to purchase the asset. Second, the lessor takes on the responsibility of repair and maintenance of the asset. In addition, leasing is useful when particular assets are required only for short periods of time or occasionally. In the long haul, though, leasing can turn out to be more expensive than the outright purchase of an asset due to the accumulated total costs of the leasing charges. Moreover, a leased asset cannot act as collateral for a business seeking a loan as an additional source of finance.

Venture capital

This is financial capital provided by investors to high-risk, high-potential start-up firms or small businesses. Venture capitalists usually fund

Key terms

Debt factoring

a financial arrangement where the debt factor takes on the responsibility for collecting the debt owed to the business and provides the business with a percentage of the owed debt in cash

Leasing

a source of finance that allows a firm to use an asset without having to purchase it by cash

Venture capital

financial capital provided by investors to high-risk, high-potential start-up firms or small businesses



start-ups that find it difficult to access money from other financial institutions or capital markets. Venture capitalists include specialist organizations and investment banks. They own a stake in the businesses they invest in with the expectation of benefiting from future profits. However, due to the high risks involved, they expect the firms needing the funds to produce a thoroughly researched business plan to help mitigate the risk of investment. The key advantage of venture capitalists is that they provide funding to businesses that other institutions might regard as too high a risk. In addition, in an effort to protect their investment they are involved in the firm's decision making by providing the required guidance where it is needed. The disadvantage is that venture capitalists may set very high profit targets for the start-up businesses they invest in and if these are not attained they usually increase their equity stake in these firms, often by a large percentage.

Key terms

Business angels

highly affluent individuals who provide financial capital to small start-ups or entrepreneurs in return for ownership equity in their businesses

Business angels

Also known as **angel investors**, these are very affluent individuals who provide financial capital to small start-ups or entrepreneurs in return for ownership equity in their businesses. They invest in high-risk businesses that show good potential for high returns or future growth. They may provide a one-time initial capital injection or continually support the businesses through their lifetime. A major advantage of business angels is that they give more favourable financial terms than other institutions or lenders of small or start-up businesses. This is because they are known to invest in the person rather than how viable a business venture is. In addition, they focus on helping a business succeed by using their extensive business experience coupled with good financial capital. The key disadvantage is that angel investors may assume a good degree of control or ownership in the businesses they invest in, therefore diluting the ownership of the entrepreneur.

Case study

Vodafone and Safaricom Kenya: Extending the Range and Reliability of Financial Services to the Poor in Rural Kenya



In Kenya there are less than two million bank accounts serving the country's population of 32 million people. The reasons for this disparity include the high cost of banking and the fact that the majority of the people have low incomes with a large percentage of them living on an average of one dollar a day. Such people do not feel comfortable interacting with commercial banks that typically target middle and upper income

customers. Micro-Finance Institutions (MFIs) such as Faulu Kenya do successfully provide financial services for the poor, but they are hampered by poor infrastructure and low levels of technology.

In order to address this problem Safaricom Kenya, one of the two mobile service providers currently operating in Kenya, developed an appropriate technology. The result was MPESA, an electronic money transfer product aimed at making financial transactions faster, cheaper and more secure. MPESA allows transfer of money between individuals, transfer of money between individuals and businesses, cash withdrawal and deposit at registered retail outlets as payment for goods and services through the mobile phone short message service (SMS). MPESA account holders

can deposit or withdraw money into or from their virtual accounts at Safaricom vendor shops or at an increasing number of outlets such as supermarkets and petrol stations. Once the money is their accounts, they can use it to pay bills, transfer to other people or purchase goods and services.

In October 2005, MPESA trials were successfully launched in Kenya, featuring eight Safaricom dealer shops and 450 Faulu Kenya clients and concluded in May 2006. Vodafone Group Plc provided 990,000 Sterling pounds and DFID 910,000 pounds sterling to finance the pilot project. Consult Hyperion a British

ICT firm developed the technology that was utilized by mobile service provider Safaricom Kenya through dealers, retailers and MFIs among others. The product has been successfully launched by Safaricom and plans are underway to recruit more financial institutions and retail outlets. Trials on new training methods for potential MPESA users are also under way. Vodafone also plans to introduce the system in other developing countries.

Summary prepared by:

Winifred N. Karugu & Triza Mwendwa (Kenya)

Student workpoint 3.3



Be a researcher

Find out how the various sources of finance for private sector organizations compare with the sources for public sector organizations.

Short-, medium- and long-term finance

In determining whether to classify a source of finance as short, medium or long term, it is important to consider the investor's personal preference or the type of asset under consideration. For example, what one investor may consider as medium term another may view as long term. There is no uniformly agreed way of determining the exact duration of a source of finance, but most financial literature uses the following definitions.

Short-term finance

This is money needed for the day-to-day running of a business and therefore provides its needed working capital. This is finance that lasts for one year or less. External short-term sources of finance are usually expected to be paid with 12 months of a trading or financial year. Examples of short-term finance include bank overdrafts, trade credit and debt factoring.

Medium-term finance

This is money mostly used to purchase assets such as equipment or vehicles that have useful lifespans for a specific period of time. This source of finance has a duration period of between one year and about five years. Examples of medium-term sources include leasing, medium-term bank loans and grants.

Long-term finance

This is funding obtained for the purpose of purchasing long-term fixed assets or other expansion requirements of a business. The duration of the finance may be anywhere from more than five to around 30 years. Long-term finance sources include long-term bank loans and share capital.

ToK discussion

What role does intuition play in financial decision making?

Is there a moral obligation for financial institutions to lend to every start-up business?



Student workpoint 3.4



Be knowledgeable

Prepare and complete a table that classifies the following sources of finance into short, medium or long term:

- debt factoring
- retained profit
- trade credit
- leasing
- sale of assets
- venture capital
- share capital
- overdrafts
- loan capital
- subsidies.

Factors influencing the choice of a source of finance

In determining the appropriateness of using a particular source of finance for a given situation, firms need to consider a number of factors which can influence their decision. Some of these factors are explored below.

Purpose or use of funds

Businesses will need to match the source of finance carefully to their specific requirements. What exactly will the finance be used for? Will it be used for the purchase of long-term fixed assets or for the short-term day-to-day running of the business? Long-term loan capital may be appropriate when purchasing a fixed asset, while trade credit may be suitable if raw materials are needed urgently in the business.

Cost

Businesses will need to consider thoroughly all the costs associated with obtaining a source of finance. Such costs include interest payments, administration costs, and costs associated with a share issue. In addition, the **opportunity cost** (the next best alternative that is forgone after choosing one source over the other) is also an important consideration when deciding on the most appropriate source of finance.

Status and size

Public limited companies can obtain finance from various sources, whereas sole traders will not be able to. This is because sole traders are

less well known and smaller in size than public limited companies. For example, the issue of shares is a source of finance that is only possible for public limited companies and not sole traders. In addition, large organizations have added collateral that they can use to negotiate for lower interest rates from financial institutions.

Amount required

For small amounts, firms may consider mostly short-term sources of finance such as bank overdrafts while, for larger amounts, long-term bank loans or the issue of shares are available options. Therefore varying sources will be used depending on the amount required.

Flexibility

This looks into the ease with which a business can switch from one source to another. In some cases businesses will need additional sources at particular points during their trading period which could be influenced by, for example, seasonal changes in demand that may require short-term sources of funding. The availability of such sources of funding in such a short period also determines how flexible it is.

State of the external environment

This involves factors that the business has no control of. For example, increases in interest rates or inflation (persistent increases in average prices in an economy) will greatly affect the purchasing decisions of both consumers and producers. Consequently, this will affect the choices businesses make in sourcing their finance. Taking up a bank loan with rising interest rates may not be the best choice for a firm because of the increased cost involved.

Gearing

This refers to the relationship between share capital and loan capital. If a company has a large proportion of loan capital to share capital it is said to be **high geared**, while a company that is **low geared** has a smaller proportion of loan capital to share capital. For example, assume there are two companies, company A and company B, each with a total capital of \$60 million. Company A may have a loan capital of US\$10 million and share capital of US\$50 million, while company B may have a loan capital of US\$40 million and share capital of US\$20 million. Company A is therefore low geared compared to company B which is high geared. High-gearred businesses are viewed as risky by financial institutions and they will be reluctant to lend money to such firms. These businesses will therefore need to seek alternative sources of finance. One way of measuring gearing is by calculating the gearing ratio (see section 3.6).



MTN Uganda achieves one of the most remarkable mobile money growth rates working with Fundamo

MTN Uganda's MobileMoney service achieved one of the most remarkable and rapid growth rates ever witnessed in the mobile financial services industry. In a year after launching, the service had registered more than one million users, 16% of its subscriber base. Today, it remains one of the world's most successful MFS deployments.



The success of the service, however, has gone far further than simply connecting the previously unbanked. The introduction of mobile payments has led to a fundamental shift in the rural and peri-urban economies.

About MTN Uganda

In October 21 1998, MTN Uganda launched commercial services in Uganda. MTN has since grown to be the leading mobile operator in the country.

MTN adopted a wireless approach to providing telecommunications services to the Ugandan market, which proved to be a convenient and fast method of rolling out services. Despite insufficient infrastructure (power, roads etc.) MTN now covers the majority of both the urban and rural population.

Uganda's financial position – the opportunity for MTN

There are over 30 banks in Uganda, but a banking penetration rate of no more than 10%.

The traditional banking model involves taking branches to various locations, an option that is not compatible with poor countries such as Uganda that cannot afford to make the investment required for such a complex infrastructure.

Furthermore, some traditional banking branches were unable to support the number of customers they can generate in an area. The advent of mobile money provided everyone with the opportunity to access financial inclusion.

This presented an opportunity for MTN Uganda to provide banking services using mobile.

The power of the MTN Fundamo partnership

MTN MobileMoney was launched as a way to allow the consumers to send and receive money, top up airtime and perform many other services using a mobile phone. MTN Uganda saw the pressing need to offer services to a population desperate for financial inclusion, and it turned to Fundamo to help roll out the ambitious national project.

MTN MobileMoney makes use of the basic Fundamo platform with an additional layer of services designed specifically for the Ugandan environment and to meet regulatory requirements.

MTN and Fundamo spent over a year in Africa before the launch of Mobile Money, interviewing potential users of this service of all ages and business sectors. This market research allowed Fundamo to refine aspects of the service to make sure that it would be well received and met the needs and aspirations of the Ugandan communities.

MTN MobileMoney is an electronic wallet service that enables you to send and receive money anywhere Uganda using your phone. MTN MobileMoney users are able to:

- Send money to any MTN mobile phone user; registered or not.
- Send money to mobile phone users on other local networks using the MTN agent network.
- Withdraw cash at any authorised MTN MobileMoney agent.
- Pay bills such as DSTv, anywhere conveniently with immediate results.
- Buy airtime for themselves and others on the MTN network directly and conveniently.
- Manage their MTN MobileMoney accounts.

The go-to-market strategy was designed to ensure rapid uptake of the services. However, even the highest hopes of the partners were exceeded by the response. It was testament to the robust Fundamo platform that MTN was able to continue to sign up new customers onto the system, relying on the integrity of the Fundamo solution.

The system was designed at the outset to handle complex transactions as the long-term view was

to migrate the users onto newer services like international remittances and mobile insurance.

MTN Uganda's success has been referenced in a number of articles looking at mobile money implementations in the developing world. The reason for the success has been the non-traditional, below the line methods used by MTN. The distribution model of "by the people, for the people" has relied on empowering the local population through education and solid entrepreneurial opportunity.

Over 2500 MobileMoney 'foot soldiers' were trained on the system. Equipped with basic infrastructure such as photocopiers, marquees, relevant marketing material and transport, the foot soldiers canvassed new users across the country.

Fundamo invested an enormous amount of time ensuring that the sign-up process was both simple and logical, while complying with all regulatory requirements. The service menu was also designed to work with even the most rudimentary handsets to ensure the service is as inclusive as possible.

Service agents are incentivised using a commission-based system which rewards them immediately upon the sign-up of new user, and on transactions levels. This was a significant boost to local communities and was warmly welcomed by governments who are looking for SMME job creation. More importantly, it

has meant that agents are driven to ensure customer satisfaction and are always on the lookout for ways to make the user-experience more rewarding.

Results

In just over a year MTN Uganda registered 1 million MobileMoney service users - 16% of its subscriber base. MTN Uganda continues to be one of the most successful Mobile Money deployments globally to date. It continues to innovate introducing new, useful services on a regular basis such as paying government pensions through the system.

Due to the success of the project, Western Union announced that it had chosen Uganda as the first country to roll out its international remittance service in partnership with MTN.

Once the new international remittance service was activated, MTN subscribers registered for MobileMoney were able to receive Western Union Money Transfer transactions in their mobile accounts. In addition, MobileMoney users in certain countries are now able to send Western Union Money Transfer transactions directly from their mobile phones for pay-out at one of Western Union's agent locations in territories around the world.

Adapted from : <http://www.fundamo.com/PDF/Case%20study/MTN%20Uganda%20Case%20Study.pdf>

Revision checklist

- ✓ Capital expenditure is money spent to acquire fixed assets in a business, which include machinery, land, buildings, vehicles and equipment, while revenue expenditure is money spent on the day to day running of a business with expenses that include rent, wages, raw materials, insurance and fuel.
- ✓ Internal sources of finance, which are obtained within the business, include personal loans, retained profits and sale of assets.
- ✓ External sources of finance that are obtained outside the business include share capital, loan capital, overdrafts, trade credit, grants, subsidies, debt factoring, leasing, venture capitalists and business angels.
- ✓ Short term finance which lasts for one year or less provides a business with its needed working capital. Medium term finance that lasts from more than one year to about five years is mostly used to purchase assets such as equipment or vehicles. Long term finance with a duration of more than five years to thirty years, is funding obtained for the purpose of purchasing long term fixed assets or other expansion requirements of a business.
- ✓ In deciding on the appropriate source of finance to use businesses need to consider; the purpose of the funds, cost, flexibility, their status and size, amount required, gearing and the state of the external environment.



Exam question

Three Hills Driving School

Three Hills Driving School provides driving instructions to people interested in obtaining a licence to drive a car. They target people aged 18 to 25 who are mostly students who have finished high school and/ or university students.

It is owned by Maria who set it up two years ago using her savings. Her capital expenditure was about \$90,000 in the first year while her revenue expenditure was half that amount in the same year. She plans to sell her business after five years as a going concern. Due to increased demand she plans on buying more cars and employing more instructors. Therefore, she will need to seek alternative sources of finance to fund this. She is debating between taking up a long term loan or a bank overdraft.

- a) Differentiate between capital expenditure and revenue expenditure [4 marks]
- b) Comment on two benefits and two drawbacks of raising money using ones savings [6 marks]
- c) Explain two medium term sources of finance available to Maria to help her expand her business [6 marks]
- d) Evaluate the view that taking up a long term loan would be a preferable option than a bank overdraft for Maria's business expansion plans. [9 marks]