2.3 Sources of Finance: Share Capital, Loan Capital and Venture Capital: 30-minute Pack

Total Marks

AQA 7132 · Calculators not allowed · about 30 minutes

Name: _____ Date: ____ / ____ / _____

Answer ALL questions in the spaces provided. Show your working for any calculation. Use the data and figures given in each question's prompt; no prior knowledge beyond what is specified is required. Where a question asks you to apply to the case, use the figures and balance sheet extracts provided in that question's prompt.

1 Explain one advantage to a high growth technology start up of accepting venture capital rather than taking a long-term bank loan. Use application to a start up planning rapid expansion that requires cash for marketing and product development.

(Total for Question 1 is 3 marks)

2 Case extract for Q13 and Q14: BrightBrew Ltd is a UK private limited company making speciality coffee machines. Balance sheet extracts (simplified) at 31 Dec: Shareholders equity: Ordinary share capital £600,000; Retained earnings £200,000. Non-current liabilities: Long-term bank loan £400,000. Current liabilities: Trade creditors £50,000. BrightBrew plans to raise £300,000 to fund a new European sales team and asks whether to issue new ordinary shares, seek venture capital, or issue a 5 year debenture. The directors are concerned about gearing and control: current gearing ratio measured as long-term debt / (long-term debt + equity) is useful. Using the extracts, calculate BrightBrew's current gearing ratio (long-term debt / (long-term debt + equity)) as a percentage to 1 decimal place, then calculate the new gearing ratio if a £300,000 debenture is issued (assume the debenture is classed as long-term debt). Show your working and state which option (share issue, venture capital or debenture) would keep gearing lowest, based on your calculations.

(Total for Question 2 is 8 marks)

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3 Explain two non-financial factors BrightBrew Ltd should consider when choosing between issuing shares, accepting VC or issuing a debenture to fund the sales expansion. Refer to relevance to the sales expansion decision in your answer.

(Total for Question 3 is 8 marks)

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Mark scheme · 2.3 Sources of Finance: Share Capital, Loan Capital and Venture Capital: 30-minute Pack

Question 1

identifies an advantage, e.g. VCs provide large amounts of equity finance suited to rapid growth	**B1**
develops the point, e.g. equity finance does not require fixed repayments, so cash flow is not burdened during scaling	**B1**
links to the scenario, e.g. this allows the start up to invest heavily in marketing and product development without the immediate pressure of loan repayments	**B1**

Answer: VCs can provide large equity investments, which do not require fixed repayments, so the start up can spend on marketing and development without immediate cash flow pressure.

Question 2

calculates current gearing numerator and denominator: long-term debt 400,000 and long-term debt + equity = 400,000 + (600,000 + 200,000) = 1,200,000	**M1**
computes current gearing as 400,000 / 1,200,000	**M1**
33.3% cao (current gearing to 1 dp)	**A1**
shows new long-term debt = 400,000 + 300,000 = 700,000 and new long-term debt + equity = 700,000 + 800,000 = 1,500,000	**M1**
computes new gearing as 700,000 / 1,500,000	**M1**
46.7% cao (new gearing to 1 dp)	**A1**
concludes which option keeps gearing lowest with reasoning, e.g. issuing shares or taking VC would increase equity and so lower gearing, whereas a debenture increases debt and raises gearing	**B1**
applies recommendation to BrightBrew, e.g. share issue or VC keeps gearing lower, and choice between share issue and VC depends on control implications	**B1**

Answer: Current gearing = 400,000 / (400,000 + 800,000) = 400,000 / 1,200,000 = 0.3333 = 33.3%. With a 300,000 debenture: gearing = 700,000 / (700,000 + 800,000) = 700,000 / 1,500,000 = 0.4667 = 46.7%. Issuing shares or taking venture capital would keep gearing lowest because they increase equity rather than debt; issuing a debenture increases gearing.

Question 3

identifies factor 1, e.g. availability of investor expertise and contacts	**B1**
develops factor 1, e.g. VC or an angel could provide market knowledge and distribution contacts vital for European sales expansion	**B1**
applies factor 1 to BrightBrew, e.g. VC involvement might speed market entry and improve sales team effectiveness	**B1**
identifies factor 2, e.g. impact on corporate governance and decision-making speed	**B1**
develops factor 2, e.g. more external shareholders or VC board seats may slow decisions due to more stakeholders to consult	**B1**
applies factor 2 to BrightBrew, e.g. slower decision-making could hinder quick local market responses in Europe	**B1**
identifies an additional non-financial factor or further develops either factor, e.g. reputational signals to partners and customers of having a reputable VC	**B1**
applies this extra point to the sales expansion context, e.g. a reputable VC could reassure distributors and speed negotiations	**B1**

Answer: Possible non-financial factors include access to investor expertise and contacts, which could directly help BrightBrew establish a European sales network and train a sales team; and the impact on corporate governance and decision speed, since more external shareholders or VC board seats may slow strategic responses needed during expansion. A third relevant factor is reputation: partnering with a reputable VC could reassure distributors and customers, aiding market entry.

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