

Sources of Finance

8 marks

AS Paper 2 2019

1 First Nature (FN)

FN is a co-operative farm producing milk, beef and vegetables. Products are sold in its shop and at local farmers' markets. FN's mission statement is in Fig. 1.1.

The sustainable production of food, to build strong relationships with members and customers and to contribute to the local community

Fig. 1.1: FN's mission statement

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The co-operative has 20 members who work on the farm, in the shop and at the markets.

Over the past 10 years FN has built up a loyal customer base. Recently, a neighbouring farm has become available to purchase for \$80 000. FN has limited capital but would like to expand by purchasing the neighbouring farm.

FN is considering sources of finance for the capital needed to buy the land. Giuseppe is one of the original members of the co-operative and has accounting skills. He has prepared the cash flow forecast shown in Table 1.1 in the business plan for the neighbouring farm.

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Table 1.1: Cash flow forecast for the neighbouring farm

	Quarter 1 (\$000)	Quarter 2 (\$000)	Quarter 3 (\$000)	Quarter 4 (\$000)
Cash Inflows				
Revenue	0	0	40	200
Total cash in	0	0	40	200
Cash Outflows				
Set-up costs	80	0	0	0
Equipment	20	10	0	10
Training	30	0	0	0
Total cash out	130	10	0	10
Opening balance	0	(130)	(140)	(100)
Closing balance	(130)	(140)	(100)	X

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FN will use the neighbouring farm to develop educational programmes for local schools and for putting on community events. The 20 members of the co-operative already work very long hours. The members are discussing whether they should allow more members or become a public limited company (plc) and employ the extra workers required. To become a public limited company would require the agreement of all 20 members. Some members are in favour of the change to a public limited company as they would become quite wealthy through selling shares. However, other members feel that it would change the relationship with its customers.

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(c) Analyse two sources of finance, other than selling shares, FN could use to purchase the neighbouring farm.

Solution

Bank loan - FN has been established for 10 years, so likely loan will be granted. But interest will have to be repaid which may mean that FN has even worse cashflow. Mortgage - The farm is a property so a mortgage would be suitable. Mortgage would have a lower interest rate than a bank loan but still reduces the profits of the business.
