2009 Paper 7 Question 6

Business Studies

(*a*) Distinguish between *debt* and *equity* financing for a young company. [5 marks]

(*b*) You have won a contract to write and supply some software and set up a company to do so. The contract is worth £100,000, with 30% payable at start, 20% at a milestone expected to be completed in month 3 after starting, 40% on delivery expected in month 6 and 10% 1 month after delivery. You will need to employ two contract programmers at a rate of £2,500 each per month (plus overheads) for the duration of the contract.

(*i*) Draw up an outline cash flow budget. What is the working capital requirement? [5 marks]

(*ii*) You raise investment of £15,000 in the company and arrange a bank loan facility up to another £15,000 (ignore bank charges and loan interest for this question). You purchase £10,000 of capital equipment initially (computers etc). Draw up the balance sheet at the end of month 6. [5 marks]

(*iii*) The project unfortunately takes an additional two months before passing the milestone. Draw up a revised cash-flow budget including the funds raised and purchases made as specified in part (*b*)(*ii*). What effect does this have on the working capital requirement? What options do the Directors have if the bank refuses to extend the loan? [5 marks]