

Short-Term Finance

Short term finance is finance available for a period of **up to one year**. It should be repaid within twelve months and should be used for short term needs. **For example:** a *bank overdraft* would be used to overcome a temporary cash deficit.

1. Credit purchases & Trade credit (used by households and businesses):

This is a regular source of short – term finance. Businesses buy goods and pay for them at a later date. Payment for these goods is normally made at the end of a week or month. This means that the money owed to the creditors can be used for other purposes until the creditors are paid. This is known as ‘leaning on the trade’. **For example:** for a business- suppliers giving a firm 60 days’ credit/ for a household- credit purchases are mainly for things such as milk, newspapers and bread, coal or oil deliveries.

Advantages:

- If used efficiently, can be a cheap source of finance
- No security required
- Control of the business is not affected if used properly
- Low involved

Disadvantages:

- Overuse of this source and slow repayments will lead to a poor credit reputation
- Possible loss of discounts for prompt payments
- Creditors retain ownership of goods until they are fully paid for

2. Bank Overdraft (used by households and businesses)

An overdraft is a short-term bank loan giving a current-account holder permission to pay out sums greater than they actually have in their current account. This involves negotiating a credit limit with the bank manager. The business may then spend money up to this limit. In return, the business must have funds in their current accounts for at least 30 days within the year and they pay interest on the outstanding daily balance. **Examples:** Households use bank overdrafts to deal with temporary shortages, such as Christmas/ a business will use a bank overdraft to pay suppliers/wages or whenever they have cash shortages.

Advantages:

- This gives a business/household great flexibility, as it knows it can pay bills even when there is no ready cash available.
- Easy to obtain and no security is usually required

Disadvantages:

- The business must remain within the agreed credit limit or else they will be charged a surcharge.
- Interest charged on an overdraft facility can be quite high

- The bank retains the right to recall the overdraft at any time.

3. Accrued Expenses (used by households and businesses)

Accrued expenses mean delaying payment of bills and using the money to pay a more urgent expense. Money can be used in the meantime for other purposes. Amounts available from this source are usually relatively small. **Example:** Services such as eircom, the ESB and SKY give customers a number of days to pay bills.

Advantages:

- No interest is involved with this source of finance
- Provided the bill is paid by the due date, the service will not be affected
- Security is not required and control will not be affected. However,

Disadvantages:

- a business or a household may risk their reputation for not paying their bills on time.
- Business/household may lose out on cash discounts for prompt payments
- Tax in a business is paid in arrears, e.g. VAT is collected in the normal course of business, and PAYE is deducted from employees' wages and remitted to the revenue commissioners at a later date. It would be very dangerous for a business to depend on this type of finance as the Revenue Commissioners will collect the money owed to them in time and high interest rates and penalties are charged to those businesses that do not meet their commitments.

4. Credit Cards (used by households)

Individuals/households can buy goods up to a certain limit without using cash, by using this source of finance. Credit card holders receive a bill once a month and are allowed 25 days from that date to pay their bill without being charged interest on purchases. **Example:** a household may use their credit card to pay for children's back-to-school uniforms and books within one week, and repay the amount over the next 3 weeks.

Advantage:

- If bill is paid within 25 days, no interest is charged

Disadvantage:

- Very high interest is charged on outstanding balances.

5. Factoring (used by businesses)

Factoring means selling the right to collect payment from debtors to a factoring (debt-collecting) firm. This involves the sale of trade debts to a factoring company and receiving 80/90 percent from the factoring company immediately and more at the end of the average collection period. Amount collected depends on the size of a firm's debtors. **For example:** Factoring *with recourse* (when bad debts occur, a factoring firm can go back to the firm it bought the debts off and get money back). Factoring *without recourse* (factoring firm loses out if a bad debt occurs).

Advantages:

- Large sums of finance can be raised quickly, if a firm has a large amount owing from debtors
- Factoring makes it easier for a business to plan their cash flow
- Factoring passes on the hassle of debt collection to a third party

Disadvantages:

- Factoring can be expensive, as factoring firms will only pay the firm a percentage of the full value of their debts
- A firm known to be factoring its debts may be seen as desperate for cash, which will damage their reputation and status

6. Invoice Discounting (business only):

Invoice discounting is when a business gets a loan from a bank to the value of some percentage (e.g. 80%) of the amount owed to the business by its customers (debtors). When these debtors settle their bills, the money is used to repay the bank.

Advantages:

- Depending on the size of a firm's debtors, large amounts may be available, which can help smooth out a firm's cashflow
- The firm retains full ownership of the debts
- No risk to the reputation of the business

Disadvantages:

- Banks charge expensive fees for this service

Activity:

- **In pairs, visit the CCPC website and look into credit cards, assume you have a CC of €4000 with interest of 22%, compare other CC providers and see if you can find a more favourable option in relation to length cost etc**

Medium Term Sources of Finance

Medium term finance is finance available for a period of **between one and five years**. It should be repaid within one to five years and should be used for medium term needs. **For Example:** a term loan may be taken out to finance new vehicles for a business.

Sample Question:

Outline and evaluate the main sources of Medium Term Finance for business and households

Solution:

1. Hire Purchase (used by households and businesses):

Hire purchase allows a household or business to buy an asset (such as a car or equipment) by paying for it in instalments over time.

A shop sells goods to a Hire Purchase (HP) company. The HP Company takes a deposit from the buyer and instalments over an agreed period of time, not exceeding five years. **Example:** Expensive equipment, such as delivery trucks, may be purchased by a business on HP

Advantages:

- Buyer has immediate use of the goods (e.g. motor vehicles, computers).
- Hire purchase costs are a legitimate business expense and can be offset against tax.
- No security is required

Disadvantages:

- Buyer does not own goods until the last instalment is made, by which time, it may have depreciated considerably in value
- HP is an expensive source of finance, as the rate of interest is high
- The asset cannot be used as security for any loans until it is fully paid for.

2. Leasing (used by households and businesses)

Leasing is renting an item, such as a vehicle or a piece of equipment, for an agreed number of years. The household/business taking out the lease must sign a contract agreeing to lease the asset for a minimum period of time. When the lease is up, the item is returned to the lessor (leaseholder), however, it is possible to buy out the asset at the end of the lease period.

Example: Assets such as motor vehicles, office equipment, computers, plant and machinery are assets commonly leased by companies, as they quickly become obsolete/depreciate in value.

Disadvantages:

- Ownership never passes to the lessee.

- A deposit is payable.

Advantages:

- No security is required and cash is not tied up.
- Repayments are tax deductible.
- As the lessee doesn't actually own the they don't have to worry about long-term obsolescence or depreciation in the value of the asset.

3. Personal loan (household) or Medium-term Loan (businesses)

A term loan is a medium term loan from a financial institution, repaid in monthly instalments over a number of years. It is negotiated with the bank manager after completing a loan application and is granted for a stated reason. A term loan for a household is called a personal loan. Large amounts of finance can be borrowed through this source. **Example:** a term loan may be taken out to finance new vehicles for a business.

Advantages:

- Term loans have lower interest rates than that of bank overdrafts.
- Interest payments are tax deductible for a business.
- Duration of the loan can be customised to suit the needs of individual borrowers in terms of repayment times and can be budgeted for in advance

Disadvantages:

- Banks may demand security for this type of loan, or may seek personal guarantees from the owners of a business that the sums involved will be repaid
- Variable interest rates mean that interest repayments can go up as well as down.
- Failure to repay can damage the firms credit rating and reputation

Long-Term Finance

Long term finance is finance available for a period of **at least five years**. It does not need to be repaid for at least five years and should be used for long term needs. **For Example:** a company raising finance through the sale and leaseback of its head office.

Sample Question:

Outline and evaluate the main sources of Long Term Finance for business and households

Solution:

1. Mortgages/Long-term loans (used by households and businesses):

Mortgages are loans used to finance the purchase of a house or other property. Large amounts of finance are available through this source.

Advantages:

- Large amounts of finance can be borrowed
- Duration of the mortgage can be customised to suit the needs of individual borrowers

Disadvantages:

- These loans are secured on the asset purchased, which means that the title deeds are given to the lender, and if the borrower defaults before the mortgage is paid in full, the financial institution can sell the asset to recoup the balance of the loan.
- Failure to repay can result in repossession of the property by the lender

2. Debenture (business only):

Debentures are long-term fixed-interest loans to businesses, secured on a valuable asset, such as premises. The firm must repay the annual rate of interest regardless of the levels of profit or loss. The principal must also be repaid in full at a future date. Very large sums are potentially available through this source.

Advantages:

- It usually carries a fixed rate of interest and a specific repayment date.
- Interest repayments can be written off against tax.
- Long-term loans will not dilute control of the firm

Disadvantages:

- Security is normally required and in the event of non-repayment, the asset used as security can be seized and sold off to settle the outstanding debt

- Although control will not be diluted, financial institutions could impose restriction on dividend pay-outs.
- May prove very expensive

3. Share Capital (Equity Share Capital or Ordinary Share Capital)

This is money invested by *owners or shareholders* into the business. Shareholders buy shares in a company. Ordinary shares entitle shareholders to vote at the AGM. Payment of dividends is not compulsory. Preference shareholders have no voting rights and have preference over ordinary shareholders in the payment of dividends and repayment of capital when winding up the company. A share issue can affect the control of a company but no security has to be provided to raise capital.

Advantages:

- If the business is set up as a limited company, it can sell shares in the business to outsiders to raise funding
- Payment of dividends is not compulsory
- No security has to be provided to raise capital through this source

Disadvantages:

- A share issue can affect the control of a company

4. Retained Earnings (Ploughing back Profits)

Retained earnings are profits of the business, which are kept back and reinvested into the business.

Advantages:

- It is a cheap source of long-term finance as no interest repayment has to be met
- No security has to be given for this source of finance

Disadvantages:

- Company directors, in consultation with shareholders, have great influence in deciding whether or not to retain profits.

5. Venture Capital (Business only)

A special type of financial institution has been formed to help firms grow. Venture Capitalists buy shares in small- and- medium-sized enterprises that have strong growth potential. These venture capital companies provide money for a limited period of time, usually in the form of a minority equity stake. It is hoped that at the end of this time the company will have grown large enough to achieve a stock exchange quotation. This allows the venture capital company to sell its shares for a large profit.

6. Sale and Leaseback (business only):

This is a contract to raise cash by selling a piece of property and simultaneously leasing it back on a long-term lease. It provides an immediate lump sum without any disruption to the business premises.

Advantages:

- Depending on the value of the asset, large sums can be raised through this source
- No direct financial risk to the business

Disadvantages:

- The business loses the ownership and ultimate control of a valuable asset
- The cost involved is the cost of the annual lease

Selecting sources of finance

Discuss the factors that should be considered when choosing between different sources of finance.

1. **The purpose of the finance:** A golden rule is that sources must be matched with uses. **For example:** a long-term business expansion plan is not financed by a bank overdraft.
2. **The cost of the finance:** The cost of finance should be affordable, especially when all other financial commitments are taken into consideration. **Examples:** In return for providing equity capital, the owner expects a return in the form of a share of profits (dividends in the case of shareholders). In return for providing loan capital, a financial institution will charge interest on the amount borrowed (a flat rate of interest) or on the amount outstanding (a true rate of interest).
3. **The control of the business:** If loan repayments cannot be kept up, some sources of finance can mean loss of control over personal or household assets which have been used as security. **Examples:** Issuing new voting shares in a company could lead to a change of power in the board of directors if the existing shareholders are unable to buy part of the issue. Using retained earnings does not affect control but may upset the owners if their dividends are reduced.
4. **The exposure to risk:** The effect of repayments on the size and timing of cash flow is important. **Examples:** *Equity* exposes the company to less risk as the share capital only has to be repaid when the company closes. If no profits are available, *dividends* do not have to be repaid. A *loan* will have a repayment schedule for both the capital and the interest, which must be met if the company is to avoid receivership or liquidation.
5. **The tax benefits:** Tax benefits may be taken into consideration when considering a source of finance as certain sources are deductible against a business's tax on profits, whereas some are not. **Example:** The payment of dividends is not deductible against the corporation's tax on profits whereas the interest on a loan is deductible.

3 factors @ 5 marks (2+3) each

2010 HL paper section 3 Part 2 Q6(C) – 15 marks

Matching source of finance with purpose

Explain why it is important that a business/household should always match the source of finance with the purpose for which it is to be used.

1. Short term

If a business has short term cash shortages, such as **(for example)** to pay employees, they could arrange a *bank overdraft*. This will allow them to overdraw their account up to a pre-arranged limit. They will only be charged interest on the daily balance outstanding. The business may then spend money up to this limit. In return, the business must have funds in their current accounts for at least 30 days within the year and they pay interest on the outstanding daily balance. This gives a business great flexibility, as it knows it can pay bills even when there is no ready cash available. However, the business must remain within the agreed credit limit or else they will be charged a surcharge. A bank overdraft is easy to obtain, very flexible and requires no security. However, the interest charged on an overdraft facility can be quite high and the bank retains the right to recall the overdraft at any time.

2. Medium term

If a business needs something that will last up to five years, such as equipment, they should arrange a *medium term loan* repayable over five years, which will allow them to spread the repayments over the useful economic life of the asset. If they used a long-term source of finance they would still be paying for the asset after it had become obsolete. A term loan is repaid in fixed instalments over an agreed period, arranged to meet the customer's ability to repay. It is negotiated with the bank manager after completing a loan application and is granted for a stated reason, such as buying vehicles. Banks may demand security for this type of loan. Term loans have lower interest rates than that of bank overdrafts. Interest payments are tax deductible for a business.

3. Long term

If a business needs premises, this requires a long - term source of finance, such as a *debenture*. By spreading the cost over 20 years or more, the business should be able to generate sufficient profit to meet repayments.

A debenture is a long-term loan to a company. It usually carries a fixed rate of interest and a specific repayment date. Security is normally required. Interest repayments can be written off against tax. Long-term loans will not dilute control, however, financial institutions could impose restriction on dividend payouts.

□ **Came up in:**

2001 section 3 part 2 Q5 (A) – 20 marks (apply to CAPDATA)

Factors lenders will consider when providing loans

The same questions may be asked of households and businesses. The difference is that businesses will provide more detailed information. Questions include the following.

Questions	Household	Business
Reasons for Loan	Car	Machinery
Ability to Repay	Salary/Wages	Final Accounts
Security	House	Premises
Own Investment	Trade-in	Share Capital
Track Record	Accounts Holder	Accounts Holder

Outline the factors that a bank may consider when assessing a loan application

Solution:

Ability to repay: The lender will assess the applicant's ability to repay the loan in the agreed time period, by looking for evidence of an applicant's income or the profits of a business. **For example:** If the risk for a bank is too high and they feel an applicant's business plan is not viable then they will not grant the loan. They may also expect the applicant to present projected profit and loss accounts and projected cash flow forecasts for their business expansion plans.

Amount & Purpose of the Loan: The larger the *amount* and the longer the duration of the loan, the riskier it is for a bank. The bank would also consider the reason for the loan. The more productive and low-risk the *purpose*, the greater the likelihood of getting approval. **For example:** if an applicant wants a loan to finance business expansion, the bank would take this into account. This is a valid reason to take out a loan also the fact that a business is already doing good will work in the applicants favour.

Track Record: The bank will take into account an applicant's credit history when assessing their loan application. An applicant with good banking history will be viewed more favourably. **For example:** If an applicant has a previous loan history and has repaid all previous loans, the bank will be more likely to grant them a loan.

- Came up in: 2014 section 3 part 2 Q6 (B) – 15 marks (3 factors AND relate to Sarah)**

Benefits of a Cash Flow Forecast

A cashflow forecast (or budget) is a document showing the planned flows of money in and out of a business or household over a certain period of time.

Explain the reasons a business/household would prepare a cash flow forecast

Highlight Cash Surpluses and Deficits: A business/household would prepare a cash flow forecast to highlight cash surpluses or deficits so that necessary steps to deal with the situation could be taken to deal with the surplus or deficit. **For example:** take out a bank overdraft to overcome a temporary deficit or they could invest a surplus to yield a higher return.

Check ability to pay bills: A business/household would prepare a cash flow forecast to check their ability to pay their bills or to meet their liabilities as they fall due. Liquidity problems are related to a shortage of cash, running the risk of a loss in reputation, credibility and loss of discount. **For example:** can they pay their creditors when payment is due.

Loan requirements: a cash flow forecast can show how much loan finance will be needed to keep a business/household afloat. Such forecasts will reassure banks (and investors for a business) that a business/household is being well managed.

Highlight weak financial management: Cash flow forecasts highlight areas of weak financial management in business/household. **For example:** giving too long a period of credit to customers (not collecting cash from debtors).

Note: Cash flow forecast can be prepared for households or businesses

□ **Came up in:**

2015 sec 3 part 2 Q6 (C) – 10 marks

2013 sec 3 part 2 Q5(C) (i) – 10 marks

2009 sec 3 part 2 Q6 (C) (i) – 10 marks

2002 sec 3 part 2 Q6 (C) (i) - 10 marks

Dealing with Cash Flow Problems

1. BUSINESS overcoming cash flow problems:

2009 sec 3 part 2 Q6 (C) (ii) – 10 marks

- (A) *Cash Flow is the lifeblood of any business and its management is critical to business survival.*

In September 2008, Buttercup Garden Centre prepared the following Cash Flow Forecast.

Cash Flow Forecast of Buttercup Garden Centre – October to December 2008				
	October	November	December	Total
	€	€	€	
Receipts				
Cash Sales	12,500	9,500	10,000	32,000
Credit Sales	2,000	1,500	3,500	7,000
Total Receipts	14,500	11,000	13,500	39,000
Payments				
Cash Purchases	1,000	2,500	4,000	7,500
Credit Purchases	5,000	2,000	1,000	8,000
Wages	6,000	6,000	7,500	19,500
Equipment	12,000	-	-	12,000
Total Payments	24,000	10,500	12,500	47,000
Net Cash	(9,500)	500	1,000	(8,000)
Opening Cash	3,000	(6,500)	(6,000)	3000
Closing Cash	(6,500)	(6,000)	(5,000)	(5,000)

Based on the information provided above, outline how Buttercup Garden Centre could improve the Cash Flow position of its business.

Solution:

Note: *in a question like this, always use **expenses** and **bank overdraft** as suggestions to improve the forecast, and make these relative to the question asked! **PLUS** if there is something else very obvious as a cash flow problem (such as **EQUIPMENT** in the above question, include this also.*

Expenses:

Buttercup Garden Centre needs to control their expenses. Wages are forecasted to rise from €6,000 to €7,500 and for the same period sales are expected to fall. They will have to review this wage increase.

Bank overdraft:

Buttercup Garden Centre could arrange to finance the deficits by arranging a bank overdraft facility for October, if they think this will be a temporary cash flow deficit. An overdraft is a short-term bank loan giving a current-account holder permission to pay out sums greater than they actually have in their current account, up to a specified limit. An overdraft is relatively easy to obtain and will give them greater flexibility.

Equipment: (compulsory point in this particular question):

Buttercup Garden Centre has a closing cash deficit in all three months. It has a net cash deficit in October; this is due to the fact that buttercup plan to buy equipment of €12,000 with cash. Equipment should be purchased using a medium source of finance (such as medium term loan, leasing or hire purchase). If buttercup acquired the Equipment using one of the above sources they would not have a cash flow problem.

 Also came up in:

2015 sec 3 part 2 Q6 (C) (iii) – 8 marks

2007 sec 3 part 2 Q6 (B) (ii) – 10 marks

2004 sec 3 part 2 Q6 (C) (ii) – 10 marks

2. HOUSEHOLDS overcoming cash flow problems:

Illustrate how a household can overcome cash flow problems

Solution:

Bank overdraft: A household could arrange to finance the deficits by arranging a bank overdraft facility, if they think this will be a temporary cash flow deficit. This will allow them to withdraw more money than what is in their account up to a specified limit. An overdraft is relatively easy to obtain and will give the household greater flexibility. **Example:** Household use overdrafts for expensive times like Christmas or perhaps to cover back to school costs.

Reduce Discretionary/ Irregular Expenditure: If a household has a cash flow problem, they may wish to examine their spending patterns and see where they could cut back. They may decide to reduce discretionary expenditure, **for example;** not spend money on a holiday or to reduce the amount of money they spend on entertainment. They may also try to minimise irregular expenditure, **for example;** try to reduce electricity costs by turning off lights or maybe shopping around to reduce food bills.

2013 sec 3 part 2 Q5 (C) (ii) – 10 marks

Elements of an effective cash flow forecast

What are the elements of an effective cashflow forecast?

- o **Realistic:** cashflow forecasts should be as realistic as possible. If in doubt, predicted income should be underestimated and predicted expenses should be overestimated
- o **Seasonal factors:** the cashflow should take into account any seasonal highs and lows in income/expenditure. **For example:** retailing tends to be very busy around Christmas but dips during the summer months
- o **Credit:** cashflow forecasts should take into account possible delays in payment for credit sales. **For example:** a business may give 60-day period of credit to debtors/for a household an employee may need to be prepared for a delay between starting a new job and receiving their first pay packet.
- o **Bad debts:** bad debts are debtors who do not pay their bills at all. Businesses that allow credit sales should make realistic provision for customers who may “go bad”.
- o **Taxes:** business cashflow is also affected by having to collect and pay taxes such as PAYE, PRSI and VAT. Businesses must regularly pay these taxes to the State.

Current Accounts

Current Accounts allow households/businesses to withdraw money whenever they want, using debit cards, cheque books, ATM machines or through online banking.

A current account is an active account in a financial institution.

- Bank statements are received regularly listing all transactions and the current balance
- If a customer wants a bank overdraft facility can be created
- Payments can be made from this account by cheque, ATM or Visa debit
- Interest on overdrafts is charged on a daily basis
- No interest is earned on money in these accounts

Current Account Application Requirements

Household	Business
Name and Address of Applicant	Name and Address of Business
Occupation	Name of Directors
Name of Employer	Nature of the Business
Income – Salary/Wages	Income - Final Accounts
Two sources of identification	Key Company Documents (e.g. Memorandum and Articles of Association)

How can current accounts assist business and household financial management?

Standing Orders: are an arrangement with the bank to pay a fixed amount out of an account at regular intervals to someone else's account. **For example:** very useful for mortgage repayment

Direct Debit: varying amounts on varied dates is paid out with the account holder's permission. **For example:** to pay ESB or mobile phone bills

Visa – Debit Card: can be used to withdraw money from ATM machine, pay for goods in a shop with account being automatically debited, obtain cash back with goods purchased

Chequebooks: allow payments to be made using cheques. A cheque is a note to the bank asking them to pay money from your account (drawer) to the person whose name is written on the cheque (payee)

Paypath: allows employers to pay wages directly into an employees account

ATM cards: allow the holder to use ATM machines to access bank services such as cash withdrawals or to pay bills. Maximum withdrawal is will depend on arrangement between institution and cardholder.

Internet/Phone Banking: allows customers to do their banking over the phone or via the Internet.

Business & Household Finance

Similarities:

Cash flow forecasts: both businesses and households can use cashflow forecasts

Action: both should take action to deal with projected surpluses (e.g. make investments) or deficits (e.g. take out a loan)

Records: both should keep accurate financial records and ensure correct amount of taxes are paid

Raising finance: both can raise finance from similar sources such as credit purchases, overdrafts, loans, etc

Financial services: both can use financial services such as current accounts

Differences:

Complexity of cashflow forecasts: business cashflow forecasts can be more complex with potentially many different sources of income and payments

Amounts: businesses finances usually deal in much larger amounts than households

Taxes: business cashflow forecasts should include regular payment of VAT and other taxes collected on behalf of the Revenue Commissioners

Additional sources of finance: businesses can access additional sources of finance not available to households, such debenture loans.

Managing a household V Managing a Business

Outline two activities that are common and two activities that are different when managing a business as opposed to managing a household.

Similarities between Managing a Household and a Business

1. Taxation

Both households and businesses must pay their taxes to the revenue commissioners. Households pay income tax, excise duties and VAT while businesses pay VAT on purchases, capital gains tax on capital gains and corporation tax on company profits.

2. Official Forms

A household and a business must fill out a wide variety of forms in the areas of finance, taxation and insurance. Both households and businesses have assets to protect, so insurance proposal forms, and in the event of accidents, claim forms, would have to be completed. Loan application forms must be filled by both. Households fill out P12's, Businesses fill out P35's, P45's and P60's.

3. Decision - Making

Decision-making is a skill that both businesses and households must engage in. Decisions in a business include deciding how much to spend on new projects, methods for recruiting new employees. Decisions in a household include deciding on who does what in the house, the type of car to purchase and choosing between alternatives.

4. Management Activities

Households and businesses get involved in the management activities of planning, organising and controlling. Both have to consider ways of achieving desired objectives by planning, both have to make sure a system is in place that allows things to happen by organising, and both have to check to make sure that the plan is working and make adjustments by controlling.

5. Raising Finance

Raising finance is common to both a household and a business, but the size of the finance required will differ. The household needs finance for the purchase of assets such as the house itself, the family car or for educational purposes, family holidays, etc. A business may need finance to purchase new assets machinery, vehicles etc or for current expenditure.

6. Communications

In the household, the lines of communications are usually between family members and outsiders. In a business the lines are downward from management, upward from subordinates, laterally between employees, outward to customers and suppliers, inward from the environment.

2002 HL paper sec 3 part 2 Q6 (A) – 20 marks

Differences between Managing a Household and a Business:

1. The Scale of the Operation

A household is usually small compared to a business enterprise with fewer people, activities and relationships. A household is less complicated to run. A business can be on a global basis and has the various complications associated with several employees, suppliers, customers etc.

2. Motivation

Motivating factors in business involve making profit, achieving job satisfaction, being market leaders etc. Whereas in the household, motivating factors centre a round the family and improving living conditions. The main motivational factor present in a household is on of family love.

3. Legislation

Both businesses and households are subject to the laws of the land.

However, businesses are subject to much more legislation than households are. (e.g. Company Law or Competition Law will not affect households)

4. Management Expertise

Specific management expertise is needed in a business e.g. marketing and accounting are regularly used and are vital to the success of a business. In a household book keeping and budgeting are certainly relevant but not to the same extent required in a business. A business has more resources and personnel than a household to carry out tasks.

2 similarities & 2 differences needed @ 5 marks (2+3) each